

The Relationship Between Business-Facilitating Legal Institutions and Foreign  
Direct Investment in The Arab Gulf States

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**Abstract**

The Gulf Cooperation Council (GCC) countries have relied on oil as their main source of income since its discovery in the region. However, these countries have now entered a new era, one in which they must reduce their dependence on oil and diversify their economies. One strategy that features in the diversification plans and visions of all GCC countries is attracting foreign direct investment (FDI). In order to successfully attract FDI, a state must identify location advantages for multinational enterprises (MNEs). It is also important to investigate the determinants of FDI. The primary question that this study attempts to answer is whether business-facilitating legal institutions play a role in attracting FDI inflows to the GCC countries. I argue that the laws and regulations that facilitate business in the GCC states contribute to the amount of FDI inflows that these states receive. The dissertation also describes the international and domestic legal framework that governs FDI in the GCC countries and compares previous and current laws and regulations on FDI in those states.

As far as the research methodology is concerned, I utilize both quantitative and qualitative techniques. For the quantitative analysis, I employ a time-series cross-sectional analysis to examine the dynamic relationship between changes in the explanatory variables and FDI inflows over the observation period. In the qualitative analysis, I draw on international investment agreements, laws, and regulations in order to compare and evaluate international and local FDI frameworks in the GCC countries.

**Keywords:** foreign direct investment (FDI), Gulf Cooperation Council (GCC), business-facilitating legal institutions.

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## DEDICATION

*This dissertation is dedicated to my father, Abdulrazak Bafarat, my mother, and my sisters.*

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## LIST OF ABBREVIATIONS

<b>Abbreviation</b>	<b>Description</b>	<b>Page</b>
(AIA)	Arab Investment Agreement	93
(AIC)	Akaike information criterion	183
(BITs)	Bilateral investment treaties	70
(EDB)	Ease of Doing Business	57
(LM)	Breusch–Pagan Lagrange multiplier	180
(OLI) paradigm	Dunning’s ownership–location–internalization paradigm.	17
(EIAs)	Economic Integration Agreements	97
(EIIAs)	Economic Integration Investment Agreements	97
(FET)	Fair and equitable treatment	81
(FDI)	Foreign direct investment	14
(FPI)	Foreign portfolio investment	25
(FTAs)	Free Trade Agreements	97
(FCN)	Friendship, Commerce, and Navigation	77
(GATT)	General Agreement on Tariffs and Trade	78
(GCC)	Gulf Cooperation Council	3
(ICSID)	International Centre for Settlement of Investment Disputes	90
(ICRG)	International country risk guide	55
(IIAs)	International Investment Agreements	21
(IMF)	International Monetary Fund	26
(IQR)	Interquartile range	192
(M&A)	Mergers and acquisitions	37
(MENA)	Middle East and North Africa	21
(MEFTA)	Middle East Free Trade Area	101
(MNEs)	Multinational enterprises	3
(NAFTA)	North American Free Trade Agreement	81
(OECD)	Organization for Economic Co-operation and Development	14
(OIC)	Organization of Islamic Cooperation	95
(OIC Investment Agreement)	Agreement on Promotion, Protection and Guarantee of Investment among Member	95

	States of the Organization of the Islamic Conference	
(Pooled OLS)	Pooled ordinary least squares	200
(RIA)	Regional Investment Agreements	92
(SAGIA)	Saudi Arabian General Investment Authority	142
(SD)	Standard deviation	192
(UEA)	Unified Economic Agreement	97
(UAE)	United Arab Emirates	13
(UNCTAD)	United Nations Conference on Trade and Development	26
(Var)	Variance	192
(WDI)	World Development Indicators	184
(WTO)	World Trade Organization	101
(WGI)	Worldwide Governance Indicators	186

# THE RELATIONSHIP BETWEEN BUSINESS-FACILITATING LEGAL INSTITUTIONS AND FOREIGN DIRECT INVESTMENT IN THE ARAB GULF STATES

## Chapter 1. INTRODUCTION

### 1.1 BACKGROUND

The Gulf Cooperation Council (GCC) is a political and economic union<sup>1</sup> of the oil-rich countries<sup>2</sup> of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE). Half of the world's oil reserves are located within the territory of the GCC.<sup>3</sup> Since the discovery of oil throughout the region—in Bahrain in 1932,<sup>4</sup> in Qatar in 1935,<sup>5</sup> in Saudi Arabia and Kuwait in 1938,<sup>6</sup> in the UAE in 1958,<sup>7</sup> and in Oman in 1964<sup>8</sup>—the GCC countries have come to rely heavily on it as a source of income. In fact, the petrochemical industry accounts for around 90% of total GCC exports.<sup>9</sup>

Oil income has become unreliable in recent years for several reasons, including increasing global interest in alternative and renewable energy sources,<sup>10</sup> the discovery of rock (shale) oil,<sup>11</sup> and the slowing production of wells in countries such as Oman.<sup>12</sup> Therefore,

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<sup>1</sup> LINDA LOW & LORRAINE CARLOS SALAZAR, *THE GULF COOPERATION COUNCIL: A RISING POWER AND LESSONS FOR ASEAN* at 3 (2011).

<sup>2</sup> *See* ROUHOLLAH K. RAMAZANI & JOSEPH A. KECHICHIAN, *THE GULF COOPERATION COUNCIL: RECORD AND ANALYSIS* at 96 (1988).

<sup>3</sup> NDIAME' DIOP ET AL., *NATURAL RESOURCE ABUNDANCE, GROWTH, AND DIVERSIFICATION IN THE MIDDLE EAST AND NORTH AFRICA: THE EFFECTS OF NATURAL RESOURCES AND THE ROLE OF POLICIES* at 153 (2012).

<sup>4</sup> LAURA S. ETHEREDGE, *PERSIAN GULF STATES: KUWAIT, QATAR, BAHRAIN, OMAN, AND THE UNITED ARAB EMIRATES* at 9 (2011).

<sup>5</sup> KRISTIAN COATES ULRICHSEN, *THE GULF STATES IN INTERNATIONAL POLITICAL ECONOMY* at 24 (2016).

<sup>6</sup> TOBY CRAIG JONES, *DESERT KINGDOM* at 11 (2010) *and* FARAH AL-NAKIB, *KUWAIT TRANSFORMED: A HISTORY OF OIL AND URBAN LIFE* at 35 (2016).

<sup>7</sup> *See* RAGAEI EL MALLAKH, *THE ECONOMIC DEVELOPMENT OF THE UNITED ARAB EMIRATES* at 88 (2014).

<sup>8</sup> ZUHAIR AHMED NAFI, *ECONOMIC AND SOCIAL DEVELOPMENT IN QATAR* at 48 (2013).

<sup>9</sup> *See* NDIAME' DIOP ET AL., *NATURAL RESOURCE ABUNDANCE, GROWTH, AND DIVERSIFICATION IN THE MIDDLE EAST AND NORTH AFRICA: THE EFFECTS OF NATURAL RESOURCES AND THE ROLE OF POLICIES* at 153 (2012).

<sup>10</sup> EMIRATES CENTER FOR STRATEGIC STUDIES AND RESEARCH, *THE FUTURE OF OIL AS A SOURCE OF ENERGY* (2003).

<sup>11</sup> Christiane Baumeister & Lutz Kilian, *Understanding the Decline in the Price of Oil Since June 2014*, 3 *JOURNAL OF THE ASSOCIATION OF ENVIRONMENTAL AND RESOURCE ECONOMISTS* 131, 151 (2016).

<sup>12</sup> *See* JEREMY JONES & NICHOLAS RIDOUT, *A HISTORY OF MODERN OMAN* at 223 (2015).



benefits host countries by creating employment,<sup>17</sup> by increasing the potential incomes of local citizens and residents,<sup>18</sup> and by introducing new technologies and skills to the job market and to society as a whole.<sup>19</sup>

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<sup>17</sup> See OECD, MIDDLE EAST AND NORTH AFRICA INVESTMENT POLICY PERSPECTIVES (2021).

<sup>18</sup> See OLIVIER DE SCHUTTER ET AL., FOREIGN DIRECT INVESTMENT AND HUMAN DEVELOPMENT: THE LAW AND ECONOMICS OF INTERNATIONAL INVESTMENT AGREEMENTS at 102-103 (2013).

<sup>19</sup> See Kamal Saggi, *Trade, Foreign Direct Investment, and International Technology Transfer: A Survey*, 17 *The World Bank Research Observer* 191, 191-235 (2002) and Ewe-Ghee. Lim, Determinants of, and the Relation Between, Foreign Direct Investment and Growth; A Summary of the Recent Literature (International Monetary Fund, Working Paper No. 01/175, 2001).

## **1.2 PROBLEM STATEMENT**

The GCC countries employ FDI as a strategy because they are intent on reducing their dependence on oil and on diversifying their economies.<sup>20</sup> In order to attract FDI and successfully diversify, each GCC country must investigate location advantages for multinational enterprises (MNEs) as well as the determinants of FDI.

Institutional quality in the host country is one determinant of FDI. This factor shapes the location decisions of MNEs and FDI inflows. Among the relevant institutions, business-facilitating legal institutions are particularly important, as the associated laws and regulations can directly affect FDI inflows. Therefore, as business-facilitating legal institutions can play a role in attracting FDI and in determining location advantages for MNEs, each GCC country must evaluate its current institutions to ensure a suitable environment for facilitating foreign business.

## **1.3 RESEARCH QUESTIONS AND HYPOTHESIS**

This study examines the following question: do the business-facilitating legal institutions of GCC countries affect FDI inflows? The primary hypothesis is that business-facilitating legal institutions are an important determinant of the volume of FDI inflows that each GCC country receives. Several related sub-questions are addressed to answer the research question and to achieve the goals of the research.

**Q1: What is the legal framework for international investment in the GCC countries?**

**(Chapter 4)**

- 1) What bilateral investment treaties has each GCC country concluded?
- 2) What regional investment agreements have the GCC countries concluded?

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<sup>20</sup> See *supra* note 14.

- 3) What economic integration and investment agreements have the GCC countries concluded?

**Q2: What is the legal framework that governs FDI in the GCC countries? (Chapter 5)**

- 1) What past and current legal frameworks govern FDI in the GCC countries?
- 2) How do FDI legal frameworks differ across GCC countries?

**Q3: What are the determinants of FDI in the GCC countries? (Chapter 6)**

- 1) What business-facilitating legal institutions affect FDI inflows in the GCC countries?
- 2) What macroeconomic factors affect FDI inflows in the GCC countries?

#### **1.4 THEORETICAL FRAMEWORK**

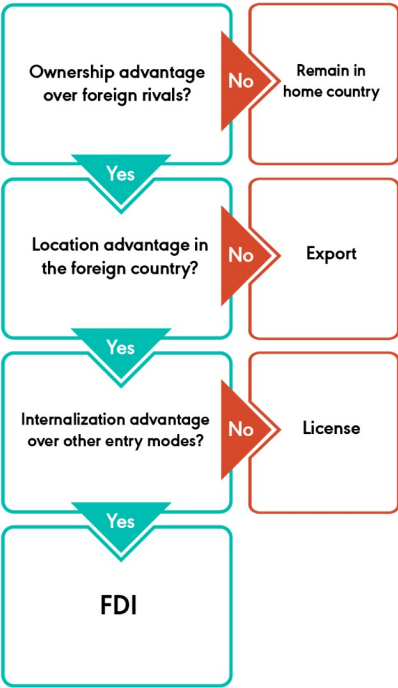
This study is based on Dunning's ownership-location-internalization (OLI) paradigm, which is also known as the eclectic theory. This holistic theory explains how an MNE can maximize its profits and when FDI is the optimal mode of entering an international market. The theory provides a three-tiered framework for MNEs to consider, and it enables such organizations to determine whether they should proceed with international investments. The three tiers are ownership advantage, location advantage, and internalization. A firm that enjoys an ownership advantage possesses unique, valuable, and hard-to-imitate assets that give it a competitive edge in foreign markets. These assets can take many forms, including intangible assets, such as patents, management skills, unique technologies, and trademarks. If a firm has no such ownership advantage, FDI might be futile; incumbents are likely to continue dominating the foreign market.

The second tier of the Dunning model concerns location advantage. Ownership advantages alone are insufficient to generate profits. The location of the investment must also be favorable. For example, there may be geographical advantages in accessing resources or markets,

labor in the foreign market may be more skilled or less expensive, and taxes or tariffs may be lower abroad.

Internalization advantage is the last element of the paradigm. The managers of an enterprise must ask themselves whether they should operate abroad or rely on external licenses or franchises. If it is more cost efficient for the MNE to use licenses to sell its products or services, it is wiser to refrain from FDI.

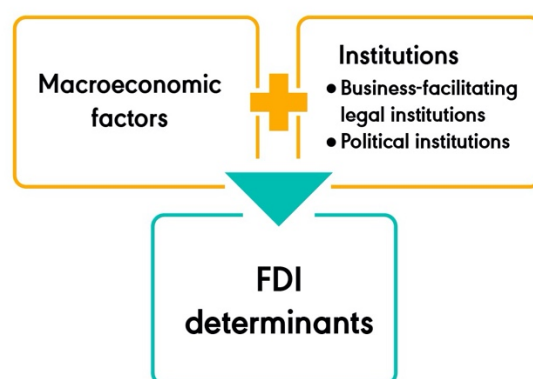
**Figure 1.1** *Dunning’s ownership-location-internalization (OLI) paradigm*



This study focuses on the second tier of the OLI paradigm, which is location advantage. I summarize several studies on location advantage in Dunning’s paradigm in the literature review chapter. Those studies attempt to establish empirical associations between different variables

(both legal and nonlegal) and FDI inflows.<sup>21</sup> One of these variables is the quality of institutions. Dunning noted that “MNEs are increasingly seeking locations which offer the best economic and institutional facilities for their core competencies to be efficiently utilized.”<sup>22</sup> Therefore, when analyzing the location decisions of MNEs and FDI inflows, it is important to examine not only macroeconomic factors in the host country, but also institutional ones.

**Figure 1.2** *FDI determinants*



North defined institutions as “the rules of the game in a society.” Scott defined them as “cognitive, normative, and regulative structures and activities that provide stability and meaning to social behavior.”<sup>23</sup> Institutions can be formal—such as laws, regulations, and judicial

<sup>21</sup> Alan Bevan et al., *Foreign Investment Location and Institutional Development in Transition Economies*, 13 INTERNATIONAL BUSINESS REVIEW 43, 43–64 (2004) and Devrim Dumludag, *An Analysis of the Determinants of Foreign Direct Investment in Turkey: The Role of the Institutional Context*, 10 JOURNAL OF BUSINESS ECONOMICS AND MANAGEMENT 15, 15–30 (2009) and Mani Govil, *Determinants of Inward FDI in Developing Countries: Evidence from a Time Series Data Analysis*, 6 ANVESHA 22, 22–29 (2013) and Mihaela Peres et al., *The Impact of Institutional Quality on Foreign Direct Investment Inflows: Evidence for Developed and Developing Countries*, 31 ECONOMIC RESEARCH-EKONOMSKA ISTRAŽIVANJA 626, 626–644 (2018) and Hadjila Krifa-Schneider & Iuliana Matei, *Business Climate, Political Risk and FDI in Developing Countries: Evidence from Panel Data*, 2 INTERNATIONAL JOURNAL OF ECONOMICS AND FINANCE 54, 54–65 (2010).

<sup>22</sup> John H. Dunning, *Location and the Multinational Enterprise: A Neglected Factor?*, 29 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 45, 45–66 (1998).

<sup>23</sup> W. RICHARD. SCOTT, INSTITUTIONS AND ORGANIZATIONS at 33 (1<sup>st</sup> ed. 1995).

systems— or informal, such as social norms, customs, and traditions that shape modes of thought in a society.<sup>24</sup> Here, I focus on formal institutions, particularly business-facilitating ones, and their association with FDI inflows in the GCC countries.

The transaction cost approach of the new institutional economics perspective explains why institutions matter for the location decisions of MNEs and FDI inflows.<sup>25</sup> The idea that underlies the neoinstitutional paradigm was first proposed by Ronald Coase.<sup>26</sup> However, it was Williamson who coined the term “new institutional economics.”<sup>27</sup> Beyond Coase and Williamson, the main contributors to the field were Douglass North and Elinor Ostrom. New institutional economics is an interdisciplinary domain that attempts to explain economic development by reference to institutions.<sup>28</sup> Neoinstitutional economists argue that the main role of institutions is to reduce transaction costs.<sup>29</sup> If the rules are unclear, uncertain, or inefficient, they may produce transaction costs.<sup>30</sup> Conversely, if the rules are clear, certain, and efficient, such additional costs become less likely. Therefore, suitable institutions lower transaction costs, and weak ones increase them. Accordingly, host countries that have superior institutions are assumed to attract more FDI than countries with poor institutions because the cost of doing business in the latter is higher.

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<sup>24</sup> DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE at 4 (1990).

<sup>25</sup> See generally Peter G. Klein, *New Institutional Economics*, in ENCYCLOPEDIA OF LAW AND ECONOMICS at 456-489 (Boudewijn Bouckaert & Gerrit de Geest, 1<sup>st</sup> ed. 2000) and Robert Grosse & Len J. Trevino, *New Institutional Economics and FDI Location in Central and Eastern Europe*, 45 MIR: MANAGEMENT INTERNATIONAL REVIEW 123, 123–145 (2005) and Len J. Trevino et al., *The Three Pillars of Institutional Theory and FDI in Latin America: An Institutionalization Process*, 17 INTERNATIONAL BUSINESS REVIEW 118, 118–133 (2008).

<sup>26</sup> OLIVER WILLIAMSON & SIDNEY WINTER, THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT (2<sup>nd</sup> ed. 1993) and RUDOLF RICHTER, ESSAYS ON NEW INSTITUTIONAL ECONOMICS at 56 (1<sup>st</sup> ed. 2015) and OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES at 27 (1975).

<sup>27</sup> RUDOLF RICHTER, ESSAYS ON NEW INSTITUTIONAL ECONOMICS at 56 (1<sup>st</sup> ed. 2015) and OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES at 1 (1975).

<sup>28</sup> See RUDOLF RICHTER, ESSAYS ON NEW INSTITUTIONAL ECONOMICS at 2 (1<sup>st</sup> ed. 2015).

<sup>29</sup> OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES at 1–6 (1975).

<sup>30</sup> See Klaus E. Meyer, *Institutions, Transaction Costs, and Entry Mode Choice in Eastern Europe*, 32 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 357, 357-367 (2001). See also DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE at 27-35 (1990).

## **1.5 RESEARCH OBJECTIVES**

This research has three aims. The first is to provide a general overview of international investment agreements (IIAs) in the GCC countries. These agreements are crucial to understanding the legal framework of FDI in the GCC states because they are a source of FDI laws and regulations. The second aim of the study is to analyze and compare the legal framework for FDI and the business environment in the six Arab Gulf states. This objective is achieved by analyzing and comparing past and current laws and regulations on FDI in the GCC countries. The third aim of the study is to assess whether business-facilitating legal institutions affect FDI inflows into GCC states. Because institutions are generally one aspect of FDI determinants, this study will consider both the legal and nonlegal (i.e., macroeconomic and political) determinants of FDI in GCC countries. Furthermore, this study specifies which business-facilitating legal institutions matter the most for attracting FDI.

## **1.6 RESEARCH SIGNIFICANCE**

This study is significant and original because it addresses three gaps in the existing literature. First, most of the existing literature on the determinants of FDI examines the GCC countries as part of a larger group, such as the Middle East and North Africa (MENA) or Arab countries.<sup>31</sup> However, as the economic and political situations of GCC countries are unique, the broad results of these studies may not accurately reflect the determinants of FDI in the GCC country. Therefore, this study exclusively focuses on the unique case of GCC countries, which cannot be studied alongside other Arab states.

Second, the limited literature that examines the determinants of FDI in the GCC countries (or which includes the GCC countries within larger groups) largely focuses on macroeconomic

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<sup>31</sup> See Chapter 3.

and political factors rather than on business-facilitating legal institutions. Studies conducted outside of the GCC have revealed the importance of business-facilitating legal institutions as determinants of FDI. For this reason, I aim to test important legal variables that have been shown to affect FDI inflows in general, but not yet in the context of the GCC countries.

Third, I compare the international legal rules that govern FDI in the GCC countries and the legal frameworks of the six states. To my knowledge, no existing study has drawn such comparisons. The resulting findings add to the understanding of the business environments in some of the most promising economies in the world.

## **1.7 RESEARCH METHODOLOGY**

In this study, I use both quantitative and qualitative research methods. I employ qualitative techniques to achieve the first and second goals of the research, to i) address the international legal rules on FDI in the GCC countries and ii) to analyze and compare the legal frameworks that govern FDI in the region. I utilize qualitative techniques to achieve the third aim, which is to highlight the determinants of FDI in the GCC countries, and to answer the main question, which concerns the relationship between business-facilitating legal institutions and FDI inflows.

In the qualitative segment of the research, I rely on documentary research in order to achieve the first and the second research objectives. I use key legal documents—namely IIAs, laws, and regulations—to compare and evaluate the legal frameworks that govern FDI in the GCC countries. I also interview legal experts in those countries in order to discover how the laws in question operate in practice.

The quantitative component of the research is premised on a time-series cross-sectional approach. I examine the dynamic relationship between changes in explanatory variables in the

GCC countries and FDI inflows over the observation period. My secondary dataset consists of balanced panel data for six GCC countries. The data cover the period between 2008 to 2017 (no data are available for the period before 2008 or after 2017). I use three estimation techniques: pooled ordinary least squares, fixed effects, and random effects. I then conduct a Hausman test to determine which estimator best fits the data.

## **1.8 DISSERTATION STRUCTURE**

The dissertation is structured into seven chapters.

**Chapter 1** introduces the research, the problem statement, the research questions and the hypothesis, and the theoretical framework of the study. It also outlines the research objectives, significance, methodology, and structure.

**Chapter 2** contains general background information about FDI. It defines FDI, differentiates it from other types of foreign investment and modes of entry, explores different types of FDI, presents explanatory theories, and details the costs and benefits of FDI.

**Chapter 3** begins with a review of the literature on the determinants of FDI in the GCC countries. As there are few such studies in this research's geographic area of interest, I examine studies that analyze the relevant determinants (macroeconomic factors, business-facilitating legal institutions, and political institutions) in other states.

**Chapter 4** addresses the international legal rules that govern FDI in the GCC countries. It explains the types of IIAs, the relevant standards, the guarantees that such treaties provide to foreign investors, and the relevant dispute resolution procedures. This chapter also discusses the IIAs to which the GCC countries are signatories, and highlights cases that foreign investors have brought against particular states.

**Chapter 5** discusses the legal frameworks that govern FDI in the six GCC countries under observation. It describes the historical development of local laws and regulations that facilitate foreign investment. I then compare the current FDI legal frameworks in the six GCC countries. This comparison is based on the following parameters: 1) foreign ownership of capital, 2) the form of the legal entity of the foreign investor, 3) the national treatment principle, 4) the corporate tax regime, 5) tariff and customs duty exemptions, 6) the transferability of capital and earnings, 7) the time and resources that must be expended to start a business, 8) real estate ownership, and 9) free trade zones.

**Chapter 6** discusses the determinants of FDI in the GCC countries and answers the main research question—whether business-facilitating legal institutions affect FDI inflows to the GCC countries—using the results of time-series cross-section analyses. I begin by describing the methodology of the research and its design, the main variables, the data, and finally the regression results. I then discuss the qualitative results in light of the main research objective.

**Chapter 7** summarizes the key findings of the dissertation. It also describes the research limitations and recommends avenues for further research.

## **Chapter 2. BACKGROUND OF FOREIGN DIRECT INVESTMENT**

*This chapter provides general background information about FDI. It starts by defining FDI. I subsequently distinguish between FDI, foreign indirect investment, and other modes of entry. I explore types and theories of FDI as well as its costs and benefits.*

### **2.1 WHAT IS FOREIGN DIRECT INVESTMENT?**

In order to understand FDI, it is crucial to grasp the meaning of the term “foreign investment” in general. The Encyclopedia of Public International Law defines “foreign investment” as “a transfer of funds or materials from one country (called the capital-exporting country) to another country (called the host country) in return for a direct or indirect participation in the earnings of that enterprise.”<sup>32</sup> In other words, foreign investment occurs when an individual or an entity from one nation invests capital in an entity in another nation. This investment can take the form of financial or physical assets. There are two main categories of foreign investment: foreign portfolio investment and FDI. I discuss those categories in the subsection that follows.

#### **2.1.1 *Foreign Portfolio Investment***

The first type of foreign investment is foreign portfolio investment, which is also often called indirect foreign investment or passive foreign investment. According to the OECD, foreign portfolio investment (FPI) is “the category of international investment that covers investment in equity and debt securities, excluding any such instruments that are classified as direct investment or reserve assets.”<sup>33</sup> The United Nations Conference on Trade and

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<sup>32</sup> M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT at 11 (2<sup>nd</sup> ed. 2004) and ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW at 246 (1981 ed.).

<sup>33</sup> OECD, OECD GLOSSARY OF STATISTICAL TERMS at 412 (2008).

Development (UNCTAD) defines FPI as “investments by a resident entity in one country in the equity and debt securities of an enterprise resident in another country which seek primarily capital gains and do not necessarily reflect a significant and lasting interest in the enterprise.”<sup>34</sup> More specifically, “The category includes investments in bonds, notes, money market instruments and financial derivatives other than those included under direct investment, or in other words, investments which are both below the ten per cent rule and do not involve affiliated enterprises.”<sup>35</sup> These definitions indicate that the definition of FPI has several key elements.

- 1) **Investment in the form of equity or debt securities.** Examples of such securities include bonds, notes, money market instruments, and financial derivatives. These instruments are tradable, meaning that they can be rapidly transferred from one shareholder to another. In fact, the International Monetary Fund (IMF) treats the tradability of instruments as an essential characteristic of FPI.<sup>36</sup>
- 2) **Passive management control.** One of the most important differences between FPI and FDI is the degree of control that the investor exercises over the management of the enterprise.<sup>37</sup> Unlike in FDI, in FPI, the investor does not significantly influence or contribute to the management of the enterprise, as the share of the investor in the enterprise does not exceed 10%.
- 3) **Short-term investment.** A further difference between FPI and FDI has to do with the length of the relationship between the investor and the enterprise. FPI is generally a more

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<sup>34</sup> UNCTAD Secretariat, COMPREHENSIVE STUDY OF THE INTERRELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT (FDI) AND FOREIGN PORTFOLIO INVESTMENT (FPI) at 4 (1999).

<sup>35</sup> *Id.*

<sup>36</sup> INTERNATIONAL MONETARY FUND (IMF), COORDINATED PORTFOLIO INVESTMENT SURVEY GUIDE (1996).

<sup>37</sup> DONALD A. BALL ET AL., INTERNATIONAL BUSINESS: THE CHALLENGE OF GLOBAL COMPETITION at 69 (7<sup>th</sup> ed. 2002).

short-term investment than FDI. The investor has no significant and lasting interest in the enterprise.

### **2.1.2** *Foreign Direct Investment*

FDI has numerous definitions. The OECD defines FDI as “a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor.”<sup>38</sup> “Lasting interest” here refers to “the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise.”<sup>39</sup> Another definition of FDI is found in the World Investment Report of UNCTAD. There, FDI is defined as “an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI) enterprise or affiliate enterprise or foreign affiliate).”<sup>40</sup> By comparison, the IMF defines FDI as an “investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise.”<sup>41</sup>

Various other definitions of FDI are available in the literature. Ball et al.,<sup>42</sup> for example, defined FDI as “investments in equipment, structures, and organizations in a foreign country at a level that is sufficient to obtain significant management control.”<sup>43</sup> Sornarajah defined it as “the

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<sup>38</sup> OECD, BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT at 234 (4<sup>th</sup> ed. 2008).

<sup>39</sup> *Id.*

<sup>40</sup> UNCTAD, TRANSNATIONAL CORPORATIONS, EXTRACTIVE INDUSTRIES AND DEVELOPMENT (2007)

<sup>41</sup> *Id.*

<sup>42</sup> DONALD A. BALL ET AL., INTERNATIONAL BUSINESS: THE CHALLENGE OF GLOBAL COMPETITION at 17 (12<sup>th</sup> ed. 2010).

<sup>43</sup> *Id.*

transfer of tangible or intangible assets from one country into another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets.”<sup>44</sup> Jensen and others equated FDI to “private capital flows that provide a parent firm with at least 10 percent control over an enterprise outside the home country, has a legacy dating back at least hundreds of years.”<sup>45</sup> Furthermore, Brown defined the concept as “the capital invested in an enterprise or a real asset by a non-resident which gives the investor a significant influence, either potential or actual, over the key policies of the enterprise or over the use of the asset.”<sup>46</sup>

At the core of these definitions lies the notion that FDI is a transfer of assets from one country (the home country) to another (the host country) with the intention of establishing a long-lasting relationship with the enterprise and exercising active control over its management. Therefore, for an investment to be classified as FDI, several conditions must be met.

- 1) **Investment in an asset.** In FDI, the investor invests in assets, whether tangible or intangible. Examples of tangible assets include cash, land, manufactures, and equipment. Stocks and bonds can also be tangible assets in FDI, as in FPI. However, unlike in FPI, investments in stocks and bonds should account for 10% or more of the equity of the enterprise in the case of FDI. Examples of intangible assets include patents, trademarks, and copyright.
- 2) **Active control over management.** In FDI, investors assume active roles in the administration and management of the foreign company, which is the main difference

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<sup>44</sup> M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* at 8 (2<sup>nd</sup> ed. 2004).

<sup>45</sup> NATHAN JENSEN ET AL., *POLITICS AND FOREIGN DIRECT INVESTMENT* at 56 (2012).

<sup>46</sup> RONALD C. BROWN, *EAST ASIAN LABOR AND EMPLOYMENT LAW: INTERNATIONAL AND COMPARATIVE CONTEXT* at 9–10 (2012).

between FDI and FPI.<sup>47</sup> Most countries define “significant role” by reference to a certain percentage of ownership. The U.S. Department of Commerce, for example, defines a foreign investment as direct when the investor acquires “an equity share of 10% or more in a domestic enterprise.”<sup>48</sup> This is also the approach of the IMF—an investment is direct “when the investor holds 10 percent or more of the equity of an enterprise.” However, the proportion may be higher in other countries. France, for instance, sets the threshold at 20%; in New Zealand, it is 25%.<sup>49</sup>

- 3) **Long-term investment.** Unlike investors in FPI, those who engage in FDI have an incentive to create and maintain long-term relationships with enterprises, as it is more difficult to terminate an FDI operation. In FDI, an investor typically has to avail themselves of liquidation processes, while in FPI, an investor only needs to sell their stock.

## 2.2 DIFFERENCES BETWEEN FDI AND OTHER MARKET ENTRY STRATEGIES FOR INTERNATIONAL BUSINESSES

Understanding the concept of FDI entails distinguishing it from other entry modes. A firm can employ several strategies to expand across borders, including exporting, licensing, and franchising.

### 2.2.1 *Exporting*

Exporting is defined as the sale of products and services to customers in a market other than that of the producing country. This process can be conducted by the producing firm or

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<sup>47</sup> DONALD A. BALL ET AL., INTERNATIONAL BUSINESS: THE CHALLENGE OF GLOBAL COMPETITION at 69 (7<sup>th</sup> ed. 2002)

<sup>48</sup> EDWARD M. GRAHAM & PAUL R. KRUGMAN, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES at 8-9 (1991).

<sup>49</sup> JOHN H. DUNNING, MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY at 12 (1<sup>st</sup> ed. 1993).





## 2.3 TYPES OF FDI

FDI can be classified in several ways. The following subsections describe different FDI classifications.

### 2.3.1 *Investment Motivations*

Dunning (1993) was the first scholar to link FDI to the motivation of investors.<sup>54</sup> In terms of investor motivation, FDI can be resource seeking, market seeking, or efficiency seeking. Each type is discussed further below.

#### 2.3.1.1 Resource-Seeking Investment

Resource-seeking investment is a type of investment in which an MNE seeks to exploit resources in the host country that are unavailable or more expensive in its home country. Accordingly, the MNE is interested in the foreign country because it can obtain these resources at a lower cost. The resources in question can vary.

- 1) Physical resources<sup>55</sup> include minerals, metals, and agricultural products.
- 2) Cheap labor is an attractive resource when the MNE uses unskilled or semi-skilled labor and operates in a country with high labor costs.<sup>56</sup> For example, many U.S. companies invest in industrializing countries such as Mexico for this reason.
- 3) Technological capability, management, or marketing expertise and organizational skills may also be sought.<sup>57</sup> For instance, U.S. companies invest in high-tech Indian companies in order to draw on their technological expertise.

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<sup>54</sup> JOHN H. DUNNING, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* (1<sup>st</sup> ed.1993).

<sup>55</sup> JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 68 (2<sup>nd</sup> ed. 2008).

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 69.

### 2.3.1.2 Market-Seeking Investment

Market-seeking investment is a type of investment in which an investor seeks to supply goods or services to a new foreign market with a view to securing a potential benefit. Those benefits include gains in market size, per capita income, and overall market growth. Dunning highlights four reasons why MNEs may choose a market-seeking investment strategy.

- 1) **Following their main supplier and/or customer bases.** MNEs may choose to engage in market-seeking investments in order to follow their main suppliers and/or customer bases overseas. When the main supplier of the MNE sets up an overseas facility or when the customer base shifts to an outside country, it is more efficient for the MNE to follow them to maintain and grow the business.
- 2) **Adapting to local market tastes.** The second reason for engaging in market-seeking FDI is to adapt the products or services of the MNE to tastes in a foreign market.<sup>58</sup> Without understanding and meeting the needs of specific markets, foreign investors would be at a disadvantage when compared to local competitors.<sup>59</sup> Proximity to the foreign market allows an MNE to remain knowledgeable about local tastes and preferences and to gauge the likelihood of changes in domestic trends.
- 3) **Cutting production and transaction costs.** If establishing a facility in a foreign country costs less than exporting products or services, then the MNE may benefit from an overseas facility.<sup>60</sup>
- 4) **Preventing competitors from expanding into the foreign market.** Maintaining a physical presence in leading markets allows businesses to discourage their

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<sup>58</sup> *Id.* at 70.

<sup>59</sup> *Id.*

<sup>60</sup> *See Id.*

competitors from expanding.<sup>61</sup> For example, the GCC operations of Coca Cola allow the company to maintain a consistent presence in the region and to challenge its main competitor, PepsiCo, which is also a leading soft drink company in the region.

### **2.3.1.3 Efficiency-Seeking Investment**

Efficiency-seeking FDI is a type of investment in which an MNE moves some of its business to another country in order to benefit from what Dunning calls “the common governance of the geographically dispersed activity.”<sup>62</sup> In other words, the MNE aims to become more competitive internationally by taking advantage of factors such as (1) economic systems and policies, (2) institutional arrangements, (3) market structure, (4) endowments, and (5) the culture of the host country.

This motivation-based classification has been criticized because it overlaps with resource-seeking FDI,<sup>63</sup> in which MNEs fragment production to exploit the resources of the host country.

### **2.3.2 *Investment Strategy***

FDI may also be classified from the perspective of the production strategy. In this taxonomy, there are two types of FDI, namely the horizontal and the vertical, which are discussed below.

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<sup>61</sup> *Id.* at 71.

<sup>62</sup> *Id.* at 72.

<sup>63</sup> Carsten Eckel, *Fragmentation, Efficiency-Seeking FDI, and Employment*, 11 REVIEW OF INTERNATIONAL ECONOMICS 317, 317–331 (2003) and Peter Nunnenkamp, *Determinants of FDI in Developing Countries: Has Globalization Changed the Rules of the Game?* (Kiel, Working Paper No. 1122, 2002).

### 2.3.2.1 Horizontal

Horizontal FDI occurs when an investing firm establishes the same or similar business activities in a foreign country.<sup>64</sup> This type of FDI can be seen as a duplication of the firm's activity in a different country.<sup>65</sup> The purpose of horizontal FDI is to expand the offering of the firm in a foreign market.<sup>66</sup> Therefore, it is driven by market access considerations.<sup>67</sup> Most FDI in the world is horizontal. Horizontal FDI usually occurs between high-income countries.<sup>68</sup>

There are two primary incentives for an MNE to pursue horizontal FDI. First, trade barriers,<sup>69</sup> such as high transportation cost<sup>70</sup> and tariffs,<sup>71</sup> can be avoided. Horizontal FDI is often seen as a superior alternative to exportation when the costs of the latter are higher than those of establishing a new entity in the foreign market. Second, FDI can often maximize profits for a firm.<sup>72</sup> By entering a foreign market, the MNE can often obtain a monopoly or oligopoly advantage due to its unique assets, products, and/or services. Examples of horizontal FDI include well-known Japanese manufacturers such as Honda, Nissan, and Toyota opening businesses in the United Kingdom.<sup>73</sup>

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<sup>64</sup> James R. Markusen, *Multinationals, Multi-Plant Economies, and the Gains from Trade*, 16 JOURNAL OF INTERNATIONAL ECONOMICS 205, 205–226 (1984).

<sup>65</sup> *Id.* and James R. Markusen & Keith Maskus, *Discriminating Among Alternative Theories of the Multinational Enterprise*, 10 REVIEW OF INTERNATIONAL ECONOMICS 694, 694 (2002) and Alexander Protsenko, *Vertical and Horizontal Foreign Direct Investments in Transition Countries* at 16 (2004) (Ph.D. dissertation, University of Munich) (on file with author) and MIKE W. PENG, *GLOBAL BUSINESS* at 177 (3<sup>rd</sup> ed. 2013).

<sup>66</sup> ELHANAN HELPMAN, *UNDERSTANDING GLOBAL TRADE* at 134 (2011)

<sup>67</sup> See GIORGIO BARBA NAVARETTI ET AL., *MULTINATIONAL FIRMS IN THE WORLD ECONOMY* at 49 (2006).

<sup>68</sup> *Id.*

<sup>69</sup> Alexander Protsenko, *Vertical and Horizontal Foreign Direct Investments in Transition Countries* at 16 (2004) (Ph.D. dissertation, University of Munich) (on file with author). See also ELHANAN HELPMAN, *UNDERSTANDING GLOBAL TRADE* at 134-135 (2011).

<sup>70</sup> Nauro F. Campos & Yuko Kinoshita, *Why Does FDI Go Where it Goes? New Evidence from the Transition Economies* (William Davidson Institute, Working Paper No. 573, 2003) at 13.

<sup>71</sup> GIORGIO BARBA NAVARETTI ET AL., *MULTINATIONAL FIRMS IN THE WORLD ECONOMY* at 49 (2006).

<sup>72</sup> Richard E. Caves, *International Corporations: The Industrial Economics of Foreign Investment*, 38 ECONOMICA 1, 4 (1971) and IMAD A. MOSSA, *FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE* at 4 (2002).

<sup>73</sup> *Id.* and GIORGIO BARBA NAVARETTI ET AL., *MULTINATIONAL FIRMS IN THE WORLD ECONOMY* at 28 (2006).

### 2.3.2.2 Vertical FDI

Vertical FDI occurs when different stages of the value chain—that is, sequences of production activities—are located in different countries.<sup>74</sup> The MNE vertically separates the stages of the value chain across borders. Vertical FDI can be forward or backward. Forward vertical FDI occurs when the firm locates the last links of its value chain, such as marketing and distribution, abroad.<sup>75</sup> In such cases, the firm intends to control the marketing and the distribution of the product or service in the foreign market. MNEs choose this type of FDI in order to better serve the prospective market by reducing the distance between itself and consumers. Toyota’s purchase of car dealerships in the US is an example of forward vertical FDI.

Backward vertical FDI, conversely, occurs when the MNE locates the first stages of the production process abroad.<sup>76</sup> In such cases, goods or components are returned to the home country, where the manufacturing process continues and the products are sold.<sup>77</sup> Backward vertical FDI typically occurs because the cost of exploiting raw materials is lower abroad than in the home country. For instance, oil companies that invest in drilling operations abroad before refining the oil domestically engage in backward vertical FDI.<sup>78</sup>

### 2.3.3 *Entry Mode (or Nature of the Business)*

FDI can also be categorized according to entry modes. Here, greenfield investments differ from mergers and acquisitions (takeovers).

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<sup>74</sup> James R. Markusen & Keith Maskus, *Discriminating Among Alternative Theories of the Multinational Enterprise*, 10 REVIEW OF INTERNATIONAL ECONOMICS 694, 694 (2002).

<sup>75</sup> ODED SHENKAR ET AL., INTERNATIONAL BUSINESS (4<sup>th</sup> ed. 2021).

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> JONATHAN SUTHERLAND & DIANE CANWELL, KEY CONCEPTS IN INTERNATIONAL BUSINESS at 11 (2<sup>nd</sup> ed. 2017).

### 2.3.3.1 Greenfield Investment

Greenfield investment is a form of FDI whereby an investor establishes a new facility in a foreign country from scratch.<sup>79</sup> This new facility can take any form, including sales or distribution offices, buildings, plants and factories,<sup>80</sup> branches, incorporated or unincorporated companies,<sup>81</sup> and subsidiaries. Examples of greenfield investments include the BMW assembly plant in South Carolina<sup>82</sup> and the Ford factory in Rayong, Thailand.<sup>83</sup>

### 2.3.3.2 Cross-Board Mergers and Acquisitions or Foreign Takeovers

FDI can also take the form of cross-board mergers and acquisitions (M&A, also called foreign takeovers or brownfield investments). Unlike in greenfield investments, in this form of FDI, the investment firm does not create a new facility in the foreign country. Instead, it purchases an existing facility through a merger or acquisition. It is worth noting that the difference between a merger and an acquisition is that a merger entails purchasing an existing facility or company,<sup>84</sup> while an acquisition has two companies join forces to form a new firm.<sup>85</sup> An example of brownfield investment is the merger between the U.S. company Kraft and the U.K. company Cadbury.<sup>86</sup>

While host countries prefer greenfield investments, MNEs generally prefer M&As. Host countries prefer greenfield investments because they are said to create more jobs, to induce

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<sup>79</sup> UNCTAD, TRAINING MANUAL ON STATISTICS FOR FDI AND THE OPERATIONS OF TNCs: INSTITUTIONAL ARRANGEMENTS FOR COLLECTING AND REPORTING FDI STATISTICS at 97 (2009). See also IMAD A. MOSSA, FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE at 13 (2002).

<sup>80</sup> UNCTAD, TRAINING MANUAL ON STATISTICS FOR FDI AND THE OPERATIONS OF TNCs: INSTITUTIONAL ARRANGEMENTS FOR COLLECTING AND REPORTING FDI STATISTICS at 97 (2009).

<sup>81</sup> *Id.*

<sup>82</sup> Eve Ross, *Incentives for Foreign Direct Investment in South Carolina: Care and Feeding of the Goose that Lays the Golden Egg*, 4 S.C. J. INT'L L. & BUS. 1, 1–27 (2007).

<sup>83</sup> S. TAMER CAVUSGIL ET AL., A FRAMEWORK OF INTERNATIONAL BUSINESS at 394 (2<sup>nd</sup> ed., 2014).

<sup>84</sup> JONATHAN JONES & COLIN WREN, FOREIGN DIRECT INVESTMENT AND THE REGIONAL ECONOMY at 20 (2016).

<sup>85</sup> *Id.*

<sup>86</sup> S. TAMER CAVUSGIL ET AL., A FRAMEWORK OF INTERNATIONAL BUSINESS at 395 (2<sup>nd</sup> ed., 2014).

transfers of technology and know-how, and to increase production capacity. MNEs prefer M&As because they are usually more cost efficient. The investing firm can access the host market quickly through an existing company.

#### **2.3.4 Ownership (Degree of Control or Ownership Strategy)**

FDI can also be classified on the basis of the degree of ownership and control that the foreign investor exercises. There are wholly foreign-owned direct investments, joint ventures, and other forms of equity participation.

##### **2.3.4.1 Wholly Foreign-Owned Direct Investment**

An MNE may own an entire company and exercise full control over its management. This outcome can be achieved by establishing a new entity, such as a greenfield investment, or by taking over an existing enterprise in the host country through acquisition.

The investments of Coca Cola in Pakistan are an example of wholly foreign-owned greenfield projects. Likewise, PepsiCo Inc. purchased the Saudi Snacks Company, the second largest salty snacks company in Saudi Arabia, in 2001. There are also countries which either prohibit full foreign ownership or restrict it to certain sectors in order to protect national businesses.

##### **2.3.4.2 Joint Venture**

Joint-venture FDI occurs when two or more firms collaborate to create a new jointly owned enterprise.<sup>87</sup> In this type of collaboration, each firm exercises partial control over the enterprise according to an agreement or the distribution of shares.<sup>88</sup> The operations of Warner

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<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

Brothers in China represent a salient example.<sup>89</sup> When Warner Brothers decided to enter the Chinese film production market, the company realized that it would be easier to collaborate with a local business that understands the market.<sup>90</sup> They went through a complex process of approval,<sup>91</sup> after which Warner Brothers is now allowed to engage in a business activity that is typically prohibited for foreigners in China.<sup>92</sup>

### 2.3.4.3 Equity Participation

Equity participation (or partial acquisition) means that the MNE acquires a part of an existing firm in the host country.<sup>93</sup> Equity participation has two elements: (1) no new business is created, and (2) the MNE shares ownership with another firm(s). Therefore, equity participation exhibits certain commonalities with both joint ventures and acquisitions.<sup>94</sup> Joint ventures also entail shared ownership and control. In acquisitions, the MNE takes over an existing enterprise.<sup>95</sup> Figure 2.1 below displays different types of FDI according to the degree of ownership and control that they entail and the status of the FDI entity.

**Figure 2.1** *FDI according to the degree of control*

	New entity	Existing entity
Full ownership	Greenfield	Acquisition

<sup>89</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 358-359 (9<sup>th</sup> ed., 2013)

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> S. TAMER CAVUSGIL ET AL., *A FRAMEWORK OF INTERNATIONAL BUSINESS* at 395 (2<sup>nd</sup> ed., 2014).

<sup>94</sup> Kristian Jakobsen & Klaus E. Meyer, *Partial Acquisition: The Overlooked Entry Mode*, in *FOREIGN DIRECT INVESTMENT, LOCATION AND COMPETITIVENESS* at 203-226 (John H. Dunning & Philippe Gugler, 2008).

<sup>95</sup> *Id.*

Shared ownership and control	Joint Venture	Equity participation
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## 2.4 THEORIES OF FDI

No single theory explains why, when, and where MNEs choose FDI over other entry modes. Nevertheless, many theories attempt to partially explain the FDI phenomenon. The following subsection summarizes some of those theories.

### 2.4.1 *The Industrial Organization Theory*

Hymer<sup>96</sup> was the first to introduce FDI to the literature.<sup>97</sup> Prior to his work, no theory explained FDI without referring to other forms of international investment. Hymer conceptualized FDI alongside the traditional theory of international capital flows. Capital flow theory suggests that international investment is a response to differences in the rates of return on capital across countries. However, this theory does not explain why firms choose to directly invest capital abroad when they can instead simply lend money. Hymer assumed that MNEs are interested not only in interest-rate benefits, but also in control. Indeed, firms choose FDI even when they are at a disadvantage in the foreign country due to market imperfections.<sup>98</sup>

According to Hymer, local firms have an advantage over foreign firms due to three barriers to entry: uncertainty (or lack of information), nationalism, and exchange-rate risk.<sup>99</sup> Hymer first described the uncertainty that is caused by a lack of information about a country

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<sup>96</sup> STEPHEN HYMER, THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT (1976)

<sup>97</sup> JONATHAN JONES & COLIN WREN, FOREIGN DIRECT INVESTMENT AND THE REGIONAL ECONOMY at 40 (2016).

<sup>98</sup> STEPHEN HYMER, THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT at 34 (1976)

<sup>99</sup> STEPHEN HYMER, THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT (1976).

(i.e., about its economy, language, law, and politics). As a result, foreign firms must shoulder additional costs in order to overcome this disadvantage when entering a new market. The second disadvantage that foreign firms face is nationalism. This barrier arises due to the discriminatory treatment of foreign firms by the government of the host country, its consumers, and its suppliers. Examples of such discrimination include limitations on the places and types of activities that foreign firms can engage in, expropriation, and consumers' preferences for familiar brands and products.<sup>100</sup> The third barrier confronted by foreign firms is exchange-rate risk, which concerns the potential for disparity between the currency in which the MNE operates and the one in which it pays out dividend.<sup>101</sup>

Hymer identified two reasons for MNE involvement in FDI despite these disadvantages. The first reason is the elimination of competition.<sup>102</sup> When MNEs enter foreign markets, say through takeovers or mergers with local firms, they can effectively eliminate competitors and acquire monopoly advantages.<sup>103</sup> The second reason is that some MNEs possess certain advantages over firms in the host country,<sup>104</sup> including intangible assets such as technology, managerial skills, and knowledge.<sup>105</sup> These ownership advantages put MNEs in a position that is superior to that of the local firms. MNEs can therefore profit from engaging in FDI despite the existence of barriers.

However, Hymer's theory is not sufficient to fully explain FDI because it does not

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<sup>100</sup> STEPHEN HYMER, *THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT* (1976).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 33.

<sup>103</sup> JONATHAN JONES & COLIN WREN, *FOREIGN DIRECT INVESTMENT AND THE REGIONAL ECONOMY* at 29 (2016).

<sup>104</sup> STEPHEN HYMER, *THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT* (1976).

<sup>105</sup> *Id.* at 41.

indicate why some countries are favored over others.<sup>106</sup> In other words, the theory does not explain why a firm would invest directly in Country A rather than in Country B.

#### 2.4.2 *Product Life Cycle Theory*

Raymond Vernon (1966)<sup>107</sup> introduced the product life cycle theory to explain when and why MNEs engage in FDI. According to Vernon, trade in manufactured products passes through four stages:<sup>108</sup> introduction, growth, maturity, and decline. One of these stages involves FDI.

- 1) **Introduction of innovation.** At this stage, the firm introduces its product to its local market.<sup>109</sup> The firm employs skilled labor in production,<sup>110</sup> and the product is sold at a high price, which is initially inelastic.<sup>111</sup> Production takes place in the country of the innovating firm (the home country) in limited quantities.<sup>112</sup> The product is improved in response to customer feedback.<sup>113</sup>
- 2) **Growth.** At this stage, demand for the product abroad grows, and competitors begin to create similar products.<sup>114</sup> Production techniques are no longer exclusive to the innovating firm, but rather are employed by other firms in the home country as well as in other developed countries.

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<sup>106</sup> See JONATHAN JONES & COLIN WREN, FOREIGN DIRECT INVESTMENT AND THE REGIONAL ECONOMY at 40 (2016).

<sup>107</sup> Raymond Vernon, *International Investment and International Trade in the Product Cycle*, 80 THE QUARTERLY JOURNAL OF ECONOMICS 190, 190-207 (1966); see also Raymond Vernon, *The Product Cycle Hypothesis in a New International Environment*, 41 OXFORD BULLETIN OF ECONOMICS AND STATISTICS 255, 255-267 (1979).

<sup>108</sup> Edward Elirehema Marandu & Tebo Ditshweu, *An Overview of the Key Theories of Foreign Direct Investment: The Way Forward*, 5 ADVANCES IN SOCIAL SCIENCES RESEARCH JOURNAL, 30, 30-39 (2018).

<sup>109</sup> IMAD A. MOSSA, FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE at 38 (2002).

<sup>110</sup> STEPHEN D. COHEN, MULTINATIONAL CORPORATIONS AND FOREIGN DIRECT INVESTMENT: AVOIDING SIMPLICITY, EMBRACING COMPLEXITY at 124 (2007).

<sup>111</sup> IMAD A. MOSSA, FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE at 38 (2002).

<sup>112</sup> STEPHEN D. COHEN, MULTINATIONAL CORPORATIONS AND FOREIGN DIRECT INVESTMENT: AVOIDING SIMPLICITY, EMBRACING COMPLEXITY at 124 (2007).

<sup>113</sup> IMAD A. MOSSA, FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE at 38 (2002).

<sup>114</sup> Edward Elirehema Marandu & Tebo Ditshweu, *An Overview of the Key Theories of Foreign Direct Investment: The Way Forward*, 5 ADVANCES IN SOCIAL SCIENCES RESEARCH JOURNAL, 30, 30-39 (2018).

- 3) Maturity.** The production techniques reach their zenith at this stage, and competition becomes stiff. To meet demand, the company must compete at lower price points and reduce tariff expenses. Therefore, the innovating firm establishes production subsidiaries abroad.<sup>115</sup> Production shifts to a country with lower costs, such as low wages, so that the firm can offer more competitive prices. At this stage, the home country of the innovating firm stops being an exporter and becomes an importer, and, in some cases, a re-exporter.<sup>116</sup> For example, the US was initially a net exporter of Apple computers. At the maturity stage, it became a net importer.
- 4) Decline:** The last stage in the life cycle of a product is decline. At this stage, demand for the product decreases.<sup>117</sup> The MNE may need to develop the product, to modify it, or to discontinue it. The MNE may also need to close some of the manufacturing facilities that it has established due to collapsing demand.

Vernon's theory successfully explains the expansion of U.S. manufacturers in the aftermath of World War II from 1950 to 1960.<sup>118</sup> However, the theory has several limitations.<sup>119</sup> First, it is only applicable to highly innovative industries, not all kinds of commercial activities.<sup>120</sup> Second, some products do not pass through all of the stages that the theory identifies. Therefore, the product life cycle theory does not provide a unified explanation of FDI.

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<sup>115</sup> Raymond Vernon, *The Product Cycle Hypothesis in a New International Environment*, 41 OXFORD BULLETIN OF ECONOMICS AND STATISTICS 255, 255–267 (1979) and Edward Elirehema Marandu & Tebo Ditshweu, *An Overview of the Key Theories of Foreign Direct Investment: The Way Forward*, 5 ADVANCES IN SOCIAL SCIENCES RESEARCH JOURNAL, 30, 30-39 (2018).

<sup>116</sup> IMAD A. MOSSA, FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE at 39 (2002).

<sup>117</sup> David R. Rink & John E. Swan, *Product Life Cycle Research: A Literature Review*, 7 JOURNAL OF BUSINESS RESEARCH 219, 219-242 (1979).

<sup>118</sup> MARIO GLOWIK, MARKET ENTRY STRATEGIES: INTERNATIONALIZATION THEORIES, CONCEPTS AND CASES OF ASIAN HIGH-TECHNOLOGY FIRMS at 19 (2<sup>nd</sup> ed. 2016).

<sup>119</sup> Grazia Ietto-Gillies, *Theories of International Production: A Critical Perspective*, 3 CRITICAL PERSPECTIVES ON INTERNATIONAL BUSINESS 196, 196–210 (2007).

<sup>120</sup> *Id.*

### 2.4.3

### *Internalization Theory*

Internalization theory was developed by Buckley and Casson.<sup>121</sup> The theory tries to explain the reason for the existence of MNEs and their preference for FDI over other means of market entry,<sup>122</sup> such as exporting, franchising, and licensing.<sup>123</sup> Its central argument is that when the external market for an intermediate product is imperfect and fails to provide a suitable environment for the innovating firm to maximize its profits, the firm creates an internal market through FDI. In this way, the firm minimizes the uncertainty,<sup>124</sup> time lags,<sup>125</sup> and bargaining and transaction costs<sup>126</sup> that inhere in other modes of market entry.

For example, if a firm needs natural minerals (an intermediate product) to manufacture its products, it can purchase a mining company instead of buying the materials from a supplier. In this way, the firm avoids uncertainty about the supplier (the external market). For example, instead of concluding distribution contracts for the marketing and warehousing of their products with local companies, Procter & Gamble (P&G) engaged in FDI,<sup>127</sup> entering the markets of several countries, including Japan<sup>128</sup> and Saudi Arabia. P&G thus eliminated the disadvantages of dealing with external partners as well as the trade barriers that are involved in the exporting process.<sup>129</sup>

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<sup>121</sup> PETER J. BUCKLEY & MARK CASSON, *A LONG-RUN THEORY OF THE MULTINATIONAL ENTERPRISE* (1<sup>st</sup> ed. 1976). *See also* Peter J. Buckley & Marc C. Casson, *Analyzing Foreign Market Entry Strategies: Extending the Internalization Approach*, 29 *JOURNAL OF INTERNATIONAL BUSINESS STUDIES* 539, 539–561 (1998).

<sup>122</sup> ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 46–47 (2012).

<sup>123</sup> Vintila Denisia, *Foreign Direct Investment Theories: An Overview of the Main FDI Theories*, 3 *EUROPEAN JOURNAL OF INTERDISCIPLINARY STUDIES* 104, 104–110 (2010).

<sup>124</sup> IMAD A. MOSSA, *FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE* at 32 (2002).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> S. TAMER CAVUSGIL ET AL., *A FRAMEWORK OF INTERNATIONAL BUSINESS* at 156 (2<sup>nd</sup> ed., 2014).

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

#### 2.4.4

#### *Dunning's Eclectic Paradigm*

Dunning's OLI paradigm, also known as the eclectic theory, also seeks to explain FDI. It describes why, when, and where firms choose to invest directly when engaging in international trade. Dunning proposed a three-step test for determining whether FDI is a suitable entry strategy for an MNE. The three limbs of the test are 1) ownership advantage, 2) location advantage, and 3) internalization.

By referring to "ownership advantage," Dunning meant that the enterprise should own a unique and valuable asset that allows it to enjoy a competitive advantage in the new market. These assets are mostly intangible and include patents, management skills, unique technologies, and particularly reputable and marketable trademarks. If this first condition is met, Dunning suggested that the enterprise proceed to the second, which is location advantage.

Location advantage requires the managers of an enterprise to identify the advantages that prospective host countries can offer, such as reliable and/or direct access to natural resources, lower wages, geographical advantages in accessing a resource or market, skilled specialized labor, low taxes or tariffs, and the general ease of doing business.

Finally, the last step of the test entails assessing internalization advantage. Managers must be able to explain why they should operate a business in another country when they can instead use external licensing or franchising. If operating in the host country is more profitable or beneficial, the enterprise should proceed with FDI.

#### **2.5 THE BENEFITS AND COSTS OF FDI**

FDI is not only beneficial to MNEs, but also countries, whether FDI-receiving countries (i.e., host countries) or FDI-sourcing countries (i.e., home countries). The following subsection highlights the benefits and costs of FDI for the host and home countries.

## 2.5.1

### *Host Country*

Attracting FDI is one of the many ways in which a modern nation state can attempt to diversify its economy and stimulate economic growth. Countries therefore create regulations to continuously attract direct investment. However, while FDI is of tremendous importance to countries that are pursuing growth strategies, it also poses disadvantages and risks. Countries must weigh the costs and benefits specific to their circumstances. The next section provides a cost-benefit analysis of FDI from the perspective of host countries.

#### 2.5.1.1 Benefits of FDI to the host country

FDI offers the following benefits for host countries.

- 1) **Positive effects on balance of payment** . The balance of payments covers all international economic transactions for a country—that is, all economic transactions between the residents of that country and the rest of the world.<sup>130</sup> The current account in the balance of payments records all exports and imports.<sup>131</sup> When the import transactions of a country exceed the exports in value, there is a deficit. If the reverse is true, there is a surplus. Host countries prefer to run trade surpluses.<sup>132</sup>

FDI has a large positive impact on the balance of payments of host countries for two reasons. First, when FDI serves as a substitute for imports, it reduces the volume of import transactions in the host country.<sup>133</sup> This change is reflected in the current account of that country. Secondly, when an MNE exports products from the host country, these transactions

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<sup>130</sup> ROBERT STERN, *BALANCE OF PAYMENTS: THEORY AND ECONOMIC POLICY* at 1 (2017).

<sup>131</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 268 (9<sup>th</sup> ed., 2013)

<sup>132</sup> *Id.*

<sup>133</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 268 (9<sup>th</sup> ed., 2013) *and* ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 72 (2012).

positively contribute to the country's balance of payments.<sup>134</sup> MNEs play a crucial role in export-led economic growth in many countries, both developing and developed.<sup>135</sup>

- 2) **Job creation.**<sup>136</sup> As foreign investors enter a market, they create new businesses that employ locals. As a result, foreign investment causes unemployment to decrease in the host country, which could eventually precipitate a fall in government expenditure on social programs for the unemployed and their dependents, such as children, the elderly, and the disabled.
- 3) **Larger incomes.**<sup>137</sup> Large corporations tend to offer better salaries and benefits than small local businesses.<sup>138</sup> Foreign investors and international corporations may therefore cause local salaries to increase, which would be reflected in the total income of the host country.
- 4) **Market competition.** FDI causes competition in the local market to intensify.<sup>139</sup> As more companies compete in the market, consumers generally pay less for commodities and services. Ideally, the quality of those commodities and services also increases.<sup>140</sup>
- 5) **Transfer of technology.**<sup>141</sup> One of the most important benefits of FDI is that it is conducive to the transfer of technology (especially in the case of investments from developed to developing countries).<sup>142</sup> Once an MNE enters a foreign market, it transfers its technology to the local individuals who participate in its operations. This transfer can facilitate

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<sup>134</sup> *Id.*

<sup>135</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 268 (9<sup>th</sup> ed., 2013) and UNITED NATIONS, *WORLD INVESTMENT REPORT* (2002).

<sup>136</sup> OECD, *MIDDLE EAST AND NORTH AFRICA INVESTMENT POLICY PERSPECTIVES* (2021).

<sup>137</sup> OLIVIER DE SCHUTTER ET AL., *FOREIGN DIRECT INVESTMENT AND HUMAN DEVELOPMENT: THE LAW AND ECONOMICS OF INTERNATIONAL INVESTMENT AGREEMENTS* at 102-103 (2013).

<sup>138</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 268 (9<sup>th</sup> ed., 2013).

<sup>139</sup> ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 70 (2012).

<sup>140</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 268-269 (9<sup>th</sup> ed., 2013).

<sup>141</sup> See Kamal Saggi, *Trade, Foreign Direct Investment, and International Technology Transfer: A Survey*, 17 *The World Bank Research Observer* 191, 191-235 (2002).

<sup>142</sup> Ewe-Ghee. Lim, *Determinants of, and the Relation Between, Foreign Direct Investment and Growth; A Summary of the Recent Literature* (International Monetary Fund, Working Paper No. 01/175, 2001).

industrialization,<sup>143</sup> and economic development in the host country.<sup>144</sup> Moreover, foreign companies invest significant amounts of money in R&D abroad. In this way, the investors are not only transferring technology, but also developing and creating it.<sup>145</sup>

- 6) Transfer of know-how and managerial skills.** Host countries can benefit from the expertise of foreign investors in developing national businesses and raising the standards of doing business. When an MNE enters a foreign market, foreign workers access otherwise unattainable know-how and managerial skills. This expertise of foreign MNEs can also stimulate local entities that deal with the MNE, such as suppliers and distributors.<sup>146</sup>

### 2.5.1.2 Cost of FDI to the host country

FDI also has several costs for host countries.

- 1) Capital outflows.** Although foreign investment generates capital for the host country, that capital does not indefinitely remain in the country. The capital, in whole or in part, must eventually return to the home country to cover the expenses of the parent company.<sup>147</sup> Moreover, FDI can have an adverse effect on the balance of payments of the host country if the MNE engages in imports from the home country or other

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<sup>143</sup> ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 69 (2012) and E. Borensztein, et al., *How Does Foreign Direct Investment Affect Economic Growth?*, 45 J. INT. ECON. 115, 115–135 (1998) and Kamal Saggi, *On Technology Transfer from Trade and Foreign Direct Investment*, 17 WORLD BANK RES OBS 191, 191–236 (2002) and Niels Hermes & Rober Lensink, *Foreign Direct Investment, Financial Development and Economic Growth*, 40 J DEV STUD 142, 142–163 (2003) and Hossein Varamini & Anh. Vu, *Foreign Direct Investment in Vietnam and Its Impact on Economic Growth*, 7 INTERNATIONAL JOURNAL OF BUSINESS RESEARCH 132, 132–139 (2007).

<sup>144</sup> Kamal Saggi, *On Technology Transfer from Trade and Foreign Direct Investment*, 17 WORLD BANK RES OBS 191, 191–236 (2002) and Niels Hermes & Rober Lensink, *Foreign Direct Investment, Financial Development and Economic Growth*, 40 J DEV STUD 142, 142–163 (2003) and Hossein Varamini & Anh. Vu, *Foreign Direct Investment in Vietnam and Its Impact on Economic Growth*, 7 INTERNATIONAL JOURNAL OF BUSINESS RESEARCH 132, 132–139 (2007) and ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 69 (2012).

<sup>145</sup> CHARLES W. L. HILL, *INTERNATIONAL BUSINESS: COMPETING IN THE GLOBAL MARKETPLACE* at 267 (9<sup>th</sup> ed., 2013)

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 270.

foreign states to the host country. The imported products are recorded as debt in the balance-of-payments account of the host country.<sup>148</sup>

- 2) **Loss of sovereignty.** FDI can jeopardize the national sovereignty of the host country if the MNE acquires excessive power and influence in the market.<sup>149</sup> Such an MNE can force the host country to adhere to its requirements, which might not align with the best interests of the country.<sup>150</sup>
- 3) **Adverse effects on competition.** Large MNEs usually have more pronounced advantages, such as experience, in the market and employ more advanced marketing strategies than local companies, especially in developing countries. While FDI can cause competition to increase, it can also bankrupt local companies and precipitate the emergence of monopolies.<sup>151</sup> The exit of local businesses from the market affects the economic growth of the host country. Moreover, a MNE that becomes a monopolist can control the market and its prices.<sup>152</sup>
- 4) **Exploitation of natural resources.** Foreign investors can exploit the natural resources of the host country without offering adequate compensation. This was the case in the Republic of the Congo between 1999 and 2002. The Congolese government transferred its mining assets to private companies without compensation.<sup>153</sup>

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<sup>148</sup> *Id.*

<sup>149</sup> *See Id.*

<sup>150</sup> *See Id.*

<sup>151</sup> ARISTIDIS BITZENIS ET AL., MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT at 71 (2012) and Kevin Honglin Zhang, *How Does Foreign Direct Investment Affect Economic Growth in China?*, 9 ECON. TRANSIT. 679, 679–693 (2001) and Rati Ram & Kevin Honglin Zhang, *Foreign Direct Investment and Economic Growth: Evidence from Cross Country Data for the 1990s*, 51 ECON DEV CULT CHANGE 205, 205–215 (2002) and Prakash Loungani and Assaf Razin, *How Beneficial Is Foreign Direct Investment for Developing Countries?*, 38 FINANCE DEV. 6, 6–9 (2001) and GORDON HOWARD HANSON, UNITED NATIONS, SHOULD COUNTRIES PROMOTE FOREIGN DIRECT INVESTMENT? (2001).

<sup>152</sup> Dukhabandhu Sahoo & Maathai K. Mathiyazhagan, *Economic Growth in India: “Does Foreign Direct Investment Inflow Matter?”*, 48 THE SINGAPORE ECONOMIC REVIEW 151, 151–171 (2003).

<sup>153</sup> *See* Suzanne Dansereau, *Win-Win or New Imperialism? Public-Private Partnerships in Africa Mining*, 32 REVIEW OF AFRICAN POLITICAL ECONOMY 47, 47–62 (2005).

**5) Adverse effects of technology transfer.** The transfer of foreign technology is not always optimal for host countries. For example, when an MNE transfers its technology to a host country but does not give local workers access to it, those workers do not gain skills, knowledge, or know-how. Furthermore, some MNEs transfer unsuitable or old technologies to the host country in order to maintain their technological advantage and foreclose competition.<sup>154</sup> This tendency causes locals to be employed in relatively low-wage positions that offer few opportunities for advancement. As a result of such imperfect transfers of technology, the host country becomes dependent on the MNE technology without sufficiently benefiting from it.

## **2.5.2 Home Country**

Home countries also benefit from FDI. What is inward FDI to the host country is outward FDI to the home country. This subsection describes the benefits of outward FDI for home countries.

### **2.5.2.1 Benefits of FDI to the home country**

FDI has fewer benefits for the home country than for the host country.

- 1) Repatriated profits.** As the profits of the MNE return to the home country, capital outflows from the host are treated as credit in the balance of payments of the home country.
- 2) Increased exports.** MNEs sometimes export parts from the home country to the host country. Such exports have a positive effect on the balance of payments of the home country.

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<sup>154</sup> Rosa Forte & Rui Moura, *The Effects of Foreign Direct Investment on The Host Country's Economic Growth: Theory And Empirical Evidence*, 58 THE SINGAPORE ECONOMIC REVIEW 1350017–1, 1350017–5 (2013) and Hüseyin Şen, *Different Arguments for And Against The Role And Impact Of Foreign Investment On The Development Potentials Of Developing Countries: An Overview*, 13 DOKUZ EYLUL UNIVERSITY, JOURNAL OF ECONOMICS AND ADMINISTRATIVE SCIENCES, 181, 181-190 (1998).

country. Exports that are related to the foreign operations of an MNE can also boost home-country employment and GDP.<sup>155</sup>

- 3) **Skills transfer.**<sup>156</sup> As previously noted, host countries benefit from the managerial skills and the know-how of foreign investors. Foreign investors can also learn from their experiences in foreign markets and apply that experience in the home country.

### 2.5.2.2 Costs of FDI to the home country

The following costs of FDI for the home country correspond to some of the benefits that accrue to the host country.

- 1) **Negative effects on balance of payments.** The balance of payments of the home country can be negatively affected in two ways. First, capital may flow from the home country to the host country to support the operations of the MNE in the latter. These capital outflows are recorded as negative in the balance of payments. Second, MNE exports from the home country decline when production shifts abroad. As result, the home country may become a net importer rather than an exporter.
- 2) **Reduction in Employment.** The employment of locals in foreign countries can result in the loss of jobs in the home country. This consideration is particularly relevant to instances in which the MNE seeks to lower its labor costs.
- 3) **Technology, know-how, and managerial skills transfer.** FDI supplies host countries with the means of accessing new skills, know-how, and technology. This transfer can result in the emergence of new international competitors, which can eventually affect the growth of the home country.

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<sup>155</sup> ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 72 (2012).

<sup>156</sup> *Id.*

### Chapter 3. LITERATURE REVIEW

There is a voluminous body of literature on FDI. Scholars have attempted to provide a unified theory on the FDI decisions of MNEs by asking the following questions: “Why does FDI happen?” “Why would an MNE choose FDI as an entry mode?” “Why do countries encourage FDI?”. The various answers to the first two questions were outlined in Chapter 2. This chapter addresses the determinants of the location of FDI (i.e., what makes a location favorable to FDI?). Many attempts have been made to identify the determinants of the location of FDI and the circumstances that lead an MNE to invest in one country rather than in another. However, these studies have failed to provide a unified general theory. Lall and Narula (2004)<sup>157</sup> and Blonigen (2005),<sup>158</sup> in their surveys of the literature, noted that research on the determinants of the location of FDI remains in its infancy and that existing theories only partially explain FDI.

The difficulty of arriving at a single theory of FDI determinants is twofold. First, the rationales, incentives, and motives for FDI differ across host countries<sup>159</sup> and over time.<sup>160</sup> Second, the same is true of the motives of MNEs, as noted in Chapter 2. For example, an MNE that has resource-seeking motives is not sensitive to the same variables as a market-seeking MNE. In the first case, labor costs are critical; in the second case, market size and purchasing power are prioritized.

In order to determine the extent to which legal institutions affect FDI inflows in the GCC countries, this chapter addresses the literature on the determinants of FDI, including that on legal institutions. Given that there are few studies on the determinants of FDI in the GCC countries

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<sup>157</sup> Sanjaya Lall & Rajneesh Narula, *Foreign Direct Investment and its Role in Economic Development: Do We Need a New Agenda?*, 16 THE EUROPEAN JOURNAL OF DEVELOPMENT RESEARCH 447 (2004).

<sup>158</sup> Bruce A. Blonigen, *A Review of the Empirical Literature on FDI Determinants*, 33 ATLANTIC ECONOMIC JOURNAL 383, 383–403 (2005).

<sup>159</sup> See ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 62 (2012).

<sup>160</sup> *Id.*

and they are not sufficient for a clear understanding to emerge, I provide an overview of studies of countries other than those in the GCC. Thus, the chapter is divided into two parts. The first covers studies on the determinants of FDI in the GCC countries, and the second covers studies on non-GCC countries. The latter section is divided into three subsections, which cover macroeconomic determinants, business-facilitating legal institutions, and political institutions.

### **3.1 STUDIES ON GCC COUNTRIES**

There are few studies on FDI in the GCC countries, and research on the relationship between business-facilitating legal institutions and FDI inflows in those countries is scarce. This section provides an account of the limited studies on the determinants of FDI in the GCC.

One of the first qualitative studies on the topic was conducted by Qasrawi (2002).<sup>161</sup> She highlighted the driving forces of FDI and the barriers to FDI in the UAE by conducting a survey among 101 transnational corporations that were operating in the region. The author found evidence of several barriers to FDI in the UAE: (a) a 49% ownership cap for foreign investors; (b) bars on the foreign ownership of real estate; (c) the agency law of the UAE; (d) red tape, restrictions, charges, and fees; and (f) the current UAE labor law. According to the survey findings, the nonlegal incentives for investing in the UAE were political stability, excellent telecommunications and banking services, the absence of taxes, potential profits, widespread familiarity with the English language, and the ability to repatriate all profits. Although the study focused on MNEs that were investing in the UAE, the author noted that the results of her research could be generalized to other GCC countries because they had similar FDI environments.<sup>162</sup>

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<sup>161</sup> SOPHIA QASRAWI, *FOREIGN DIRECT INVESTMENT IN THE UAE: DETERMINANTS AND RECOMMENDATIONS* (1<sup>st</sup> ed. 2004).

<sup>162</sup> *Id.*

Mina (2007)<sup>163</sup> attempted to ascertain the determinants of FDI in the GCC countries. Using panel data for six GCC countries on the period between 1980 and 2002, the author found that oil production, oil reserves, and oil prices negatively affected FDI inflows and that oil utilization was conducive to FDI. Moreover, Mina (2007) found that trade openness, infrastructure development, and institutional quality exhibited a positive and significant relationship with FDI inflows to the GCC countries. However, human capital significantly limited those inflows. The author measured institution quality by using the International Country Risk Guide (ICRG) rule-of-law indicator. This indicator “reflects the degree to which the citizens of a country are willing to accept the established institutions to pass and implement laws and adjudicate disputes.”<sup>164</sup>

Eltayeb (2010)<sup>165</sup> analyzed the main determinants of FDI in MENA countries—including all six GCC countries—between 1975 and 2006. The study concluded that the size of the host economy, its government, its natural resources, and its institutional variables (captured by the level of corruption and investment profiles) were the key determinants of FDI inflows in MENA countries. External factors—such as global liquidity and trade variables—had no significant effect on the determinants of FDI. The study therefore suggests that MENA countries that attract lower FDI inflows should remove trade barriers, develop their financial systems, reduce corruption, improve policy, and adopt appropriate institutions. Moreover, it indicates that privatization and macroeconomic stability are important factors for FDI inflows and should not be overlooked.

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<sup>163</sup> Wasseem Mina, *The Location Determinants of FDI in the GCC Countries*, 17 JOURNAL OF MULTINATIONAL FINANCIAL MANAGEMENT 336, 336–348 (2007).

<sup>164</sup> *Id.*

<sup>165</sup> Sufian Eltayeb Mohamed & Moise G. Sidiropoulos, *Another Look at the Determinants of Foreign Direct Investment in MENA Countries: An Empirical Investigation*, 35 JOURNAL OF ECONOMIC DEVELOPMENT 75, 75–90 (2010).

Gani and Al-Abri (2013)<sup>166</sup> investigated the effects of the business environment and institutional indicators on FDI inflows in four GCC countries—Kuwait, Oman, Saudi Arabia, and the UAE—between 2003 and 2010. The researchers chose five indicators of the ease of doing business as business environment variables: the time that it takes to start a business, the cost of starting a business, the time that is needed to register a property, the time that is necessary to enforce contracts, and the time that it takes for insolvency proceedings to conclude. The institutional variables that the authors examined were political stability, democracy, the rule of law, and corruption. They also introduced controls for economic growth, trade, and market size. The study concluded that there is a negative and significant correlation between FDI inflows and the time that is needed to start a business, enforce a contract, register a property, and complete insolvency proceedings. Furthermore, political stability, democracy, the rule of law, and corruption were not significantly correlated with FDI inflows.

Elheddad (2016)<sup>167</sup> studied the relationship between FDI inflows and natural resources in the GCC countries, particularly oil, between 1980 and 2014. He concluded that the association between oil rents and FDI inflows to the GCC countries is negative, which supports the oil curse theory. Moreover, according to his findings, trade openness and a suitable labor force encourage FDI in those countries, while political instability and corruption deter MNEs from engaging in such investment.

Aziz and Mishra (2016)<sup>168</sup> attempted to employ the Arellano–Bover/Blundell–Bond linear dynamic panel data estimation technique to identify the determinants of FDI inflows in 16

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<sup>166</sup> Azmat Gani & Almukhtar Saif Al-Abri., *Indicators of Business Environment, Institutional Quality and Foreign Direct Investment in Gulf Cooperation Council (GCC) Countries*, 27 INTERNATIONAL REVIEW OF APPLIED ECONOMICS 515, 515–530 (2013).

<sup>167</sup> Mohamed Mahjoub Elheddad, *Natural Resources and FDI in GCC Countries*, 6 INTERNATIONAL JOURNAL OF BUSINESS AND SOCIAL RESEARCH 12, 12–22 (2016).

<sup>168</sup> Omar G Aziz & Anil V. Mishra, *Determinants of FDI Inflows to Arab Economies*, 25 THE JOURNAL OF INTERNATIONAL TRADE & ECONOMIC DEVELOPMENT 325, 325–356 (2016).

Arab countries, including all six GCC states. The authors found that market size, trade openness, preferential trade agreements, and financial development had a positive impact on FDI inflows to these countries. They also found evidence that superior institutions (measured by government stability, investment profiles, and corruption on the ICRG index) and an educated labor force can play a key role in attracting FDI inflows.

Hussan (2017)<sup>169</sup> examined panel data from nine Middle Eastern countries (including all six GCC states) to isolate potential determinants of FDI inflows. He found that purchasing power, human capital, and trade openness were the key drivers of FDI inflows in the states under observation. Interestingly, GDP growth rate, gross capital formation, and inflation had no significant relationship with FDI inflows.

Aziz (2017)<sup>170</sup> studied the quality of institutions as one of several variables that determine FDI inflows to Arab and GCC countries. He tried to connect institutional quality to FDI inflows by using panel data for 16 Arab countries (including all GCC countries) over the period 1984–2012. Aziz (2017) selected institutional variables from different data indexes that are compiled by international organizations. The variables in question were government stability, investment profile, law and order, corruption, democratic accountability, bureaucracy quality, and military involvement in politics. These variables were chosen from the following indexes: Ease of Doing Business (EDB) by the World Bank, Economic Freedom by the Fraser Institute, and the ICRG by the Political Risk Services group. Aziz (2017) found that institution quality, as it manifests in the doing-business variables, as well as economic freedom and international country risk (ICRG) had a positive and significant impact on FDI inflows to the

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<sup>169</sup> Munir Hassan, *Determinants of Foreign Direct Investment in the Middle East Region: An Empirical Analysis*, 13 ASIAN SOCIAL SCIENCE 47, 47–53 (2017).

<sup>170</sup> Omar Ghazy Aziz, *Institutional Quality and FDI Inflows in Arab Economies*, 25 FINANCE RESEARCH LETTERS 111, 111–123 (2018).

Arab economies.

### **3.2 DETERMINANTS OF THE LOCATION OF FDI**

The literature on the determinants of the location of FDI is extensive. These determinants can be categorized into three types: macroeconomic factors, business-facilitating legal institutions, and political institutions. The literature on each category is discussed in the subsection that follows.

#### **3.2.1 *Macroeconomic Factors***

Early studies on the determinants of FDI inflows and the classical approach focused mainly on macroeconomic factors in host countries.<sup>171</sup> The literature considers a wide range of macroeconomic variables that affect FDI inflows, and some variables have received more attention than others. These economic variables include market size, GDP growth, and inflation. The following paragraphs review the literature on each variable.

##### **3.2.1.1 Market Size**

Market size is the most widely accepted determinant of FDI, especially for market-seeking investments, as described in Chapter 2. Almost all empirical studies that test the determinants of FDI account for market size.<sup>172</sup> According to the market size hypothesis, which was proposed by Balassa (1966)<sup>173</sup> and developed by Scaperlanda and Mauer (1969),<sup>174</sup> the larger the market, the more promising the opportunities for MNEs to realize economies of scale.

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<sup>171</sup> Simran K. Kahai, *Traditional and Non-Traditional Determinants of Foreign Direct Investment in Developing Countries*, 20 JOURNAL OF APPLIED BUSINESS RESEARCH 43, 43–50 (2004).

<sup>172</sup> Pravin Jadhav, *Determinants of Foreign Direct Investment in BRICS Economies: Analysis of Economic, Institutional and Political Factor*, 37 PROCEDIA-SOCIAL AND BEHAVIORAL SCIENCES 5, 5–14 (2012).

<sup>173</sup> Bela Balassa, *Exports and Economic Growth: Further Evidence*, 5 JOURNAL OF DEVELOPMENT ECONOMICS 181, 181–189 (1978) and Muhammad Azamand & Ling Lukman, *Determinants of Foreign Direct Investment in India, Indonesia and Pakistan: A Quantitative Approach*, 4 JOURNAL OF MANAGERIAL SCIENCES 31, 31–44 (2010).

<sup>174</sup> Anthony E. Scaperlanda & Laurence J. Mauer, *The Determinants of US Direct Investment in the EEC*, 59 THE AMERICAN ECONOMIC REVIEW 558, 558–568 (1969).

Many empirical studies report a positive association between market size and FDI inflows in both developed and developing countries. These studies include the work of the following researchers: Scaperlanda and Mauer (1969),<sup>175</sup> who wrote on U.S. investments in the European Economic Community; Bandera and White (1968),<sup>176</sup> who focused on U.S. firms investing in seven European economies; Root and Ahmed (1979),<sup>177</sup> who covered FDI in 70 developing countries; Davidson (1980),<sup>178</sup> who examined 20 developed and developing countries; Lunn (1980),<sup>179</sup> who studied U.S. FDI in the European Economic Community; Nigh (1985),<sup>180</sup> who examined a sample of U.S. investments in 24 developed and developing countries; Schneider and Frey (1985),<sup>181</sup> who drew on a sample of 80 less developed countries; Culem (1988),<sup>182</sup> who discussed U.S. investments in six industrialized countries (the US, Germany, France, the UK, the Netherlands, and Belgium); Wheeler and Mody (1992),<sup>183</sup> who covered a sample of U.S. investments in 42 developing countries and industrialized economies; Tsai (1994),<sup>184</sup> who drew on a mixed sample of low-, median-, and high-income countries;

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<sup>175</sup> Anthony E. Scaperlanda & Laurence J. Mauer, *The Determinants of US Direct Investment in the EEC*, 59 THE AMERICAN ECONOMIC REVIEW 558, 558–568 (1969).

<sup>176</sup> Vladimir N. Bandera & Joseph T. White, *US Direct Investments and Domestic Markets in Europe*, 21 ECONOMIA INTERNAZIONALE 117, 117–233 (1968).

<sup>177</sup> Franklin R. Root & Ahmed A. Ahmed, *Empirical Determinants of Manufacturing Direct Foreign Investment in Developing Countries*, 27 ECONOMIC DEVELOPMENT AND CULTURAL CHANGE 751, 751–767 (1979).

<sup>178</sup> William H. Davidson, *The Location of Foreign Direct Investment Activity: Country Characteristics and Experience Effects*, 11 J INT BUS STUD 9, 9–22 (1980).

<sup>179</sup> John Lunn, *Determinants of US Direct Investment in the EEC: Further Evidence*, 13 EUROPEAN ECONOMIC REVIEW 93, 93–101 (1980).

<sup>180</sup> Douglas Nigh, *The Effect of Political Events on United States Direct Foreign Investment: A Pooled Time-Series Cross-Sectional Analysis*, 16 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 1, 1–17 (1985).

<sup>181</sup> Friedrich Schneider & Bruno S. Frey, *Economic and Political Determinants of Foreign Direct Investment*, 13 WORLD DEVELOPMENT 161, 161–175 (1985).

<sup>182</sup> Claudy G. Culem, *The Locational Determinants of Direct Investments Among Industrialized Countries*, 32 EUROPEAN ECONOMIC REVIEW 885, 885–904 (1988).

<sup>183</sup> David Wheeler & Ashoka Mody, *International Investment Location Decisions: The Case of US Firms*, 33 JOURNAL OF INTERNATIONAL ECONOMICS 57, 57–76 (1992).

<sup>184</sup> Pan-Long Tsai, *Determinants of Foreign Direct Investment and its Impact on Economic Growth*, 19 JOURNAL OF ECONOMIC DEVELOPMENT 137, 137–163 (1994).

Shamsuddin (1994),<sup>185</sup> who discussed 23 less developed countries; Chunlai (1997),<sup>186</sup> who analyzed 33 developing countries; Billington (1999),<sup>187</sup> who focused on FDI inflows to 11 regions of the UK; Lipsey (1999),<sup>188</sup> who wrote on U.S. investments in 10 Asian countries (China, Hong Kong, India, Korea, Taiwan, Indonesia, Malaysia, Philippines, Singapore, and Thailand); Zhang and Markusen (1999),<sup>189</sup> who examined developing countries, including Bahrain, Oman, and Saudi Arabia; Hailu (2010),<sup>190</sup> who reported findings on African countries; Schneier and Matei (2010),<sup>191</sup> who examined 33 developing and transitional economies; Mohamed and Sidiropoulos (2010),<sup>192</sup> whose sample included 36 countries and all six GCC states; Razmi and Behname (2012),<sup>193</sup> who studied eight Islamic countries (Turkey, Yemen, Oman, Malaysia, Egypt, Pakistan, Algeria, and Iran); and Khachoo and Khan (2012),<sup>194</sup> who considered a sample of 32 developing countries.

Although most studies report a positive relationship between market size and FDI

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<sup>185</sup> Abul F. M. Shamsuddin, *Economic Determinants of Foreign Direct Investment in Less Developed Countries*, 33 THE PAKISTAN DEVELOPMENT REVIEW 41, 41–51 (1994).

<sup>186</sup> Chen Chunlai, *The Location Determinants of Foreign Direct Investment in Developing Countries* (Chinese Economies Research Centre, Working Paper No.97/12, 1997).

<sup>187</sup> Nicholas Billington, *The Location of Foreign Direct Investment: An Empirical Analysis*, 31 APPLIED ECONOMICS 65, 65–76 (1999).

<sup>188</sup> Robert E. Lipsey, *The Location and Characteristics of US Affiliates in Asia* (National Bureau of Economic Research, Working Paper No. w6876, 1999).

<sup>189</sup> Kevin Honglin Zhang & James R. Markusen., *Vertical Multinationals and Host-Country Characteristics*, 59 JOURNAL OF DEVELOPMENT ECONOMICS 233, 233–252 (1999).

<sup>190</sup> Zenegnaw Abiy Hailu, *Demand Side Factors Affecting the Inflow of Foreign Direct Investment to African Countries: Does Capital Market Matter?*, 5 INTERNATIONAL JOURNAL OF BUSINESS AND MANAGEMENT 104, 104–116 (2010).

<sup>191</sup> Hadjila Krifa-Schneider & Iuliana Matei, *Business Climate, Political Risk and FDI in Developing Countries: Evidence from Panel Data*, 2 INTERNATIONAL JOURNAL OF ECONOMICS AND FINANCE 54, 54–65 (2010).

<sup>192</sup> Sufian Eltayeb Mohamed & Moise G. Sidiropoulos, *Another Look at the Determinants of Foreign Direct Investment in MENA Countries: An Empirical Investigation*, 35 JOURNAL OF ECONOMIC DEVELOPMENT 75, 75–90 (2010).

<sup>193</sup> Mohammad Javad Razmi & Mehdi Behname, *FDI Determinants and Oil Effects on Foreign Direct Investment: Evidence from Islamic Countries*, 2 ADVANCES IN MANAGEMENT AND APPLIED ECONOMICS 261, 261–270 (2012).

<sup>194</sup> Ab Quyoom Khachoo & Mohd Imran Khan, *Determinants of FDI Inflows to Developing Countries: A Panel Data Analysis* (Munich Personal RePEc Archive, Paper No. 37278, 2012).

inflows, some arrived at insignificant results. For example, Loree and Guisinger (1995)<sup>195</sup> found no significant correlations when examining U.S. investments in 48 developed and developing countries. Hausmann and Fernandez-Arias (2000)<sup>196</sup> drew the same conclusion from a study of Latin American countries.

Moreover, studies such as that by Edwards (1990)<sup>197</sup> indicate that the relationship between GDP per capita and FDI inflows is negative. Edwards (1990) concluded that in the case of FDI in developing countries, “countries with lower income per capita, larger internal markets, and domestic investment ratios will tend to be more attractive [for FDI].”<sup>198</sup>

Researchers measure market size by using different methods. The most common methods of measuring market size rely on GDP per capita, population, or both. Wilhelms (1998) used population to measure market size and GDP per capita to measure market fitness.<sup>199</sup> Alessandrini (2000) also applied this approach.<sup>200</sup> Authors who have measured market size by using GDP per capita include Root and Ahmed (1979),<sup>201</sup> Loree and Guisinger (1995),<sup>202</sup> Tsai (1994),<sup>203</sup> and Petrović-Randelović et al. (2017).<sup>204</sup> Petrović-Randelović et al. (2017) also included population as an explanatory variable.

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<sup>195</sup> David W. Loree & Stephen E. Guisinger, *Policy and Non-Policy Determinants of US Equity Foreign Direct Investment*, 26 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 281, 281–299 (1995).

<sup>196</sup> Ricardo Hausmann & Eduardo Fernandez-Arias, *Foreign Direct Investment: Good Cholesterol? (Inter-American Development Bank (IDB), Working Paper No. 417, 2000)*.

<sup>197</sup> Sebastian Edwards, *Capital Flows, Foreign Direct Investment, and Debt-Equity Swaps in Developing Countries (National Bureau of Economic Research, Working Paper No. w3497, 1990)*.

<sup>198</sup> *Id.*

<sup>199</sup> SASKIA KS WILHELMS & MORGAN STANLEY DEAN WITTER, *FOREIGN DIRECT INVESTMENT AND ITS DETERMINANTS IN EMERGING ECONOMIES* (1998).

<sup>200</sup> Sergio Alessandrini & Laura Resmini, *FDI in the Mediterranean Region: A Comparison with CEE Experience (Munich Personal RePEc Archive, Paper No. 26103, 2000)*.

<sup>201</sup> Franklin R. Root & Ahmed A. Ahmed, *Empirical Determinants of Manufacturing Direct Foreign Investment in Developing Countries*, 27 ECONOMIC DEVELOPMENT AND CULTURAL CHANGE 751, 751–767 (1979).

<sup>202</sup> David W. Loree & Stephen E. Guisinger, *Policy and Non-Policy Determinants of US Equity Foreign Direct Investment*, 26 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 281, 281–299 (1995).

<sup>203</sup> Pan-Long Tsai, *Determinants of Foreign Direct Investment and its Impact on Economic Growth*, 19 JOURNAL OF ECONOMIC DEVELOPMENT 137, 137–163 (1994).

<sup>204</sup> Marija Petrović-Randelović et al., *Market Size as a Determinant of the Foreign Direct Investment Inflows in the Western Balkans Countries*, 14 FACTA UNIVERSITATIS. SERIES: ECONOMICS AND ORGANIZATION 93, 93–104 (2017).

### 3.2.1.2 GDP Growth

Annual GDP growth has also emerged as a determinant of FDI in the literature. However, this variable has received less attention than market size.<sup>205</sup> While market size captures the potential of host-country markets, GDP growth predicts future market potential.<sup>206</sup> According to UNCTAD (1998, 2000),<sup>207</sup> some market-seeking foreign investors seek to invest not only in countries with large domestic markets, but also in countries that are growing rapidly.

Most empirical studies report a positive relationship between GDP growth and FDI inflows. Those studies include the work of the following researchers: Schneider and Frey (1985),<sup>208</sup> who examined a sample of 80 less developed countries; Culem (1988),<sup>209</sup> who wrote on U.S. direct investment in six industrialized countries (the US, Germany, France, the UK, the Netherlands, and Belgium); Clegg (1995),<sup>210</sup> who studied U.S. foreign investment in Europe; Clegg and Scott-Green (1998), who were concerned with the investments of Japanese firms in Europe; Billington (1999),<sup>211</sup> who focused on FDI inflows in 11 regions of the UK; Chakrabarti (2001),<sup>212</sup> who analyzed 135 countries, including Oman, a GCC country; Choi (2003),<sup>213</sup> who

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<sup>205</sup> Muhammad Tariq Majeed & Eatnaz Ahmad, *FDI and Exports in Developing Countries: Theory and Evidence*, 46 THE PAKISTAN DEVELOPMENT REVIEW 735, 735–750 (2007).

<sup>206</sup> Muhammad Tariq Majeed & Eatnaz Ahmad, *FDI and Exports in Developing Countries: Theory and Evidence*, 46 THE PAKISTAN DEVELOPMENT REVIEW 735, 735–750 (2007).

<sup>207</sup> UNCTAD, *WORLD INVESTMENT REPORT 1998: TRENDS AND DETERMINANTS (1998)* and UNCTAD, *CROSS-BORDER MERGERS AND ACQUISITIONS AND DEVELOPMENT (2000)*.

<sup>208</sup> Friedrich Schneider & Bruno S. Frey, *Economic and Political Determinants of Foreign Direct Investment*, 13 WORLD DEVELOPMENT 161, 161–175 (1985).

<sup>209</sup> Claudy G. Culem, *The Locational Determinants of Direct Investments Among Industrialized Countries*, 32 EUROPEAN ECONOMIC REVIEW 885, 885–904 (1988).

<sup>210</sup> Jeremy Clegg & Susan Scott-Green, *The Determinants of Japanese Foreign Direct Investment Flows to the European Community, 1963-1990*, 6 MULTINATIONAL LOCATION STRATEGY 29, 29–49 (1998).

<sup>211</sup> Nicholas Billington, *The Location of Foreign Direct Investment: An Empirical Analysis*, 31 APPLIED ECONOMICS 65, 65–76 (1999).

<sup>212</sup> Avik Chakrabarti, *The Determinants of Foreign Direct Investments: Sensitivity Analyses of Cross-Country Regressions*, 54 KYKLOS 89, 89–114 (2001).

<sup>213</sup> Changkyu Choi, *Does the Internet Stimulate Inward Foreign Direct Investment?*, 25 JOURNAL OF POLICY MODELING 319, 319–326 (2003).

covered a sample of 53 countries; Mottaleb (2007),<sup>214</sup> who focused on 60 low- and lower-middle-income countries; and Majeed and Ahmad (2009),<sup>215</sup> who studied a panel of 72 developing countries.

Some studies report that the relationship between GDP growth and FDI inflows is insignificant. Examples include the work of Nigh (1988),<sup>216</sup> who focused on U.S. firms that invested in 24 developed and developing countries; Tsai (1994),<sup>217</sup> who studied a mixed sample of low-, median, and high-income countries; and Shamsuddin (1994),<sup>218</sup> who focused on 38 less developed countries.

The literature on FDI in the GCC emphasizes market size rather than GDP growth when attempting to identify the determinants of FDI. One of the few studies that tested the effect of GDP growth on FDI inflows in GCC states is that of Hussan (2017).<sup>219</sup> In his study of nine MENA countries, including the six GCC members, Hussan (2017) found that GDP growth was insignificantly related to FDI inflows.

### 3.2.1.3 Inflation Rate

The rate of inflation has received considerable attention in the literature on the determinants of FDI inflows. Low inflation is indicative of economic stability; high inflation

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<sup>214</sup> Khondoker Abdul. Mottaleb, Determinants of Foreign Direct Investment and its Impact on Economic Growth in Developing Countries (Munich Personal RePEc Archive, Paper No. 9457, 2007).

<sup>215</sup> Muhammad Tariq Majeed & Eatzaz Ahmad, *An Analysis of Host Country Characteristics that Determine FDI in Developing Countries: Recent Panel Data Evidence*, 14 LAHORE JOURNAL OF ECONOMICS 71, 71–96 (2009).

<sup>216</sup> Douglas Nigh, *The Effect of Political Events on United States Direct Foreign Investment: A Pooled Time-Series Cross-Sectional Analysis*, 16 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 1, 1–17 (1985).

<sup>217</sup> Pan-Long Tsai, *Determinants of Foreign Direct Investment and its Impact on Economic Growth*, 19 JOURNAL OF ECONOMIC DEVELOPMENT 137, 137–163 (1994).

<sup>218</sup> Abul F. M. Shamsuddin, *Economic Determinants of Foreign Direct Investment in Less Developed Countries*, 33 THE PAKISTAN DEVELOPMENT REVIEW 41, 41–51 (1994).

<sup>219</sup> Munir Hassan, *Determinants of Foreign Direct Investment in the Middle East Region: An Empirical Analysis*, 13 ASIAN SOCIAL SCIENCE 47, 47–53 (2017).

suggests instability.<sup>220</sup> The lower the inflation rate, the greater the likelihood of FDI.<sup>221</sup> Thus, a number of studies—including those by Ahn and Willett (1998)<sup>222</sup> and Zhao, Delios, and Yang (2002)—report a negative relationship between inflation and FDI inflows.<sup>223</sup>

However, in the literature on the GCC countries, this relationship has been found to be insignificant. Alshamsi, Hussin, and Azam (2015),<sup>224</sup> who focused on the UAE, found that the inflation rate had no significant effect on FDI in their study period. The authors explained this finding by arguing that inflation below a certain threshold has no effect on FDI.<sup>225</sup> In addition, Hussan (2017)<sup>226</sup> examined panel data from nine Middle Eastern countries (including all six GCC countries) and found that inflation rates had an insignificant effect on FDI inflows.

### 3.2.2 *Institutions*

As noted in Chapter 1, “MNEs are increasingly seeking locations which offer the best economic and institutional facilities for their core competencies to be efficiently utilized.”<sup>227</sup> Therefore, when analyzing the determinants of FDI and location advantages for MNEs, it is important to examine not only a host country’s macroeconomic factors, but also its institutions. The literature on institutions can be divided into two categories: the literature on legal

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<sup>220</sup> Arfan Shahzad & Abdullah Kaid Al-Swidi, *Effect of Macroeconomic Variables on the FDI Inflows: The Moderating Role of Political Stability: An Evidence from Pakistan*, 9 ASIAN SOCIAL SCIENCE 270, 270–279 (2013) and Oludele Akinloye Akinboade et al., *Foreign Direct Investment in South Africa*, in FOREIGN DIRECT INVESTMENT IN SUB-SAHARAN AFRICA: ORIGINS, TARGETS, IMPACT AND POTENTIAL at 177-208 (S. Ibi Ajayi, 2006).

<sup>221</sup> *Id.*

<sup>222</sup> Young Seok Ahn et al., *The Effects of Inflation and Exchange Rate Policies on Direct Investment to Developing Countries*, 12 INTERNATIONAL ECONOMIC JOURNAL 95, 95–104 (1998).

<sup>223</sup> Changhui Zhou et al., *Locational Determinants of Japanese Foreign Direct Investment in China*, 19 ASIA PACIFIC JOURNAL OF MANAGEMENT 63, 63–86 (2002).

<sup>224</sup> Khamis Hareb Alshamsi et al., *The Impact of Inflation and GDP Per Capita on Foreign Direct Investment: The Case of United Arab Emirates*, 12 INVESTMENT MANAGEMENT AND FINANCIAL INNOVATIONS 132, 132–141 (2015).

<sup>225</sup> *Id.* at 139.

<sup>226</sup> Munir Hassan, *Determinants of Foreign Direct Investment in the Middle East Region: An Empirical Analysis*, 13 ASIAN SOCIAL SCIENCE 47, 47–53 (2017).

<sup>227</sup> John H. Dunning, *Location and the Multinational Enterprise: A Neglected Factor?*, 29 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 45, 45–66 (1998).

regulations that facilitate business and the literature on political institutions. The subsections that follow cover the two categories.

### 3.2.2.1 Business-Facilitating Legal Institutions

Although the existing literature highlights the importance of institutions and the quality of regulation, the laws that matter the most for MNE location decisions are yet to be identified. The optimal approach is to empirically test selected institutional models against FDI inflows for specific countries.<sup>228</sup> Numerous empirical studies have tested such associations. Scholars have used different terms to define the quality of law in the host country, including “legal institution,” “economic institution,” “investment climate,” “legal regulations,” “business environment,” “business climate,” and “regulation of foreign direct investment.” I use the term “business-facilitating legal institutions” to capture the formal rules (laws and regulations) of host countries that support foreign businesses. It is important to note that *political institutions*, such as stability and corruption, are beyond the scope of this research and are addressed as a separate category in paragraph 3.2.2.2. The empirical studies that are summarized here test the association between business-facilitating legal institutions and FDI inflows. These studies treat different variables as proxies for business-facilitating legal institutions.

Busse and Groizard (2008)<sup>229</sup> examined whether countries need a sound business environment, in the form of suitable regulations, to benefit from FDI. The soundness of the business environment was tested by reference to five types of government regulations, namely business start-up regulations, labor market regulations, contract regulations, creditor rights, and insolvency regulations. The sample consisted of 87 developed and developing countries,

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<sup>228</sup> Robert Grosse & Len J. Trevino, *New Institutional Economics and FDI Location in Central and Eastern Europe*, 45 *MIR: MANAGEMENT INTERNATIONAL REVIEW* 123, 123–145 (2005).

<sup>229</sup> Matthias Busse & José Luis Groizard, *Foreign Direct Investment, Regulations and Growth*, 31 *WORLD ECONOMY* 861, 861-886 (2008).

including Saudi Arabia and the US. The findings revealed that countries with excessive regulations benefited less from FDI inflows. In fact, countries with high regulatory standards saw limited FDI growth. These results support the hypothesis that FDI flows to countries with more efficient regulations.

Piwonski (2010)<sup>230</sup> tested the relationship between what she called “government actions” and FDI inflows by utilizing aggregated indicators from the EDB index as proxies. The indicators in question concerned starting a business, dealing with construction permits, acquiring electricity, registering property, obtaining credit, the protection of minority investors, taxation, cross-border trade, contract enforcement, and insolvency proceedings. The study aimed to reveal whether there is a connection between changes in FDI inflows and the EDB ranking of each country. To accomplish this goal, Piwonski (2010) ran a regression model on a sample of countries in the World Bank Survey between 2004 and 2010. She concluded that the higher the aggregate EDB score of a country, the higher the volume of FDI inflows that it attracts. A host country can attract more than \$44 million in FDI by moving up a rank in the EDB index.

Morris and Aziz (2011)<sup>231</sup> studied the relationship between business climate and FDI inflows in 57 Asian and Sub-Saharan countries. The study used EDB indicators as proxies for the business climates of the sample countries. Using a simple regression analysis, they concluded that, out of the 10 EDB indicators, only registering property and trading across borders had a significant relationship with FDI inflows over the entire period under observation (2000–2005). The other indicators exhibited such a relationship only for the year 2000.

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<sup>230</sup> Katherine Piwonski, Does the ‘Ease of Doing Business’ in a Country Influence its Foreign Direct Investment Inflows? (2010) (Senior Capstone Project, Bryant University) (on file with author).

<sup>231</sup> Rosetta Morris & Abdul Aziz, *Ease of Doing Business and FDI Inflow to Sub-Saharan Africa and Asian Countries*, 18 CROSS CULTURAL MANAGEMENT: AN INTERNATIONAL JOURNAL 400, 400–411 (2011).

Bissoon (2012)<sup>232</sup> studied the impact of institutional quality (measured by control over corruption, regulatory quality, and political stability) on FDI controlling for economic factors such as real GDP, exports and imports, infrastructure, inflation, the real exchange rate, and government expenditure. He used ordinary least squares regression to analyze data for 45 developing countries in Africa, Latin America, and Asia over the period between 1996 and 2005. The results revealed that a less volatile inflation rate, control over corruption, a sound regulatory framework, and political stability had a positive effect on FDI inflows.

Bayraktar (2015)<sup>233</sup> questioned the reason for the shift of the direction of FDI from developed toward developing countries. One way to explain this phenomenon is to analyze correlations between EDB scores and FDI inflows. To that end, Bayraktar (2015) analyzed all of the countries that were included in the index between 2004 and 2010. She found that the countries that had scored better on EDB attracted more FDI.

Vogiatzoglou (2016)<sup>234</sup> investigated the relationship between regulatory systems and FDI inflows to the Association of Southeast Asian Nations (ASEAN) over the period 2003–2013. The study found that several variables—starting and closing a business, contract enforcement, labor markets, trading across borders, and the tax system—affected the location decisions of MNEs and FDI inflows into the countries under observation.

Sabir et al. (2019)<sup>235</sup> examined the effect of institutional quality on FDI inflows to developed and developing countries over the period 1996–2016. The researchers measured

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<sup>232</sup> Ourvashi Bissoon, *Can Better Institutions Attract More Foreign Direct Investment (FDI)? Evidence from Developing Countries*, 11 JOURNAL OF EUROPEAN ECONOMY 38, 38–61 (2012).

<sup>233</sup> Nihal Bayraktar, *Importance of Investment Climates for Inflows of Foreign Direct Investment in Developing Countries*, 5 BUSINESS AND ECONOMIC RESEARCH 24, 24–50 (2015).

<sup>234</sup> Klimis Vogiatzoglou, *Ease of Doing Business and FDI Inflows in ASEAN*, 33 JOURNAL OF SOUTHEAST ASIAN ECONOMIES 343, 343–363 (2016).

<sup>235</sup> Samina Sabir et al., *Institutions and FDI: Evidence from Developed and Developing Countries*, 5 FINANCIAL INNOVATION 1, 1–20 (2019).

institutional quality by using six variables from the World Governance Indicators: control over corruption, political stability, the rule of law, regulatory quality, voice and accountability, and government effectiveness. They controlled for inflation, GDP per capita, trade openness (measured as a percentage of GDP), value added by agriculture (measured as a percentage of GDP), and infrastructure. The results showed that control over corruption, political stability, the rule of law, regulatory quality, voice and accountability, and government effectiveness had a positive and significant effect on FDI in developed countries. However, only control over corruption, government effectiveness, and political stability had a positive and significant effect on FDI inflows to developing countries. The coefficients of the other institutional factors for the developing countries were positive but insignificant. Sabir et al. (2019) concluded that “institutional quality has a greater impact on FDI in developed countries than in developing countries.”<sup>236</sup>

Nnadozie and Njuguna (2022),<sup>237</sup> Olival (2012),<sup>238</sup> Shahadan et al. (2014),<sup>239</sup> and Akame et al. (2014)<sup>240</sup> arrived at similar results. Nevertheless, there is a lack of consensus in the field. For example, Ali et al. (2010)<sup>241</sup> used the ICRG index as a proxy for institutional quality in 107 countries between 1981 and 2005. The results indicate that institutional quality in the primary sector did not have a significant effect on FDI inflows. However, institutions mattered in

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<sup>236</sup> Samina Sabir et al., *Institutions and FDI: Evidence from Developed and Developing Countries*, 5 FINANCIAL INNOVATION 1, 1–20 (2019).

<sup>237</sup> Angelica E. Njuguna & Emmanuel Nnadozie, *Investment Climate and Foreign Direct Investment in Africa: The Role of Ease of Doing Business*, JOURNAL OF AFRICAN TRADE 1, 1-24 (2022).

<sup>238</sup> Andreia Isabel do Nascimento Olival, *The Influence of Doing Business' Institutional Variables in Foreign Direct Investment* (2012) (M.S. thesis, Universidade Católica Portuguesa) (on file with author).

<sup>239</sup> Faridah Shahadan et al., *Relationships Between Doing Business Indexes and FDI Net Inflows: Empirical Evidence From Six Asian Countries (Afghanistan, Bangladesh, India, Iran, Pakistan and Sri Lanka)*, KE-9 PROSIDING PERSIDANGAN KEBANGSAAN EKONOMI MALAYSIA 609, 609–625 (2014).

<sup>240</sup> Afuge Junior Akame et al., *The Impact of Business Climate on Foreign Direct Investment in the CEMAC Region*, 7 JOURNAL OF ECONOMICS AND SUSTAINABLE DEVELOPMENT 66, 66–74 (2016).

<sup>241</sup> Fathi A. Ali et al., *Do Institutions Matter for Foreign Direct Investment?*, 21 OPEN ECONOMIES REVIEW 201, 201–219 (2010).

manufacturing and, in particular, in services. The institutions that mattered the most were property rights, the rule of law, and expropriation risk.

Mengistu and Adhikary (2011)<sup>242</sup> analyzed the effect of “good governance” on FDI inflows to China, Hong Kong, Indonesia, South Korea, Singapore, Malaysia, Thailand, the Philippines, Vietnam, Cambodia, Brunei, India, Pakistan, Bangladesh, and Sri Lanka between 1996 and 2007. The components of good governance were voice and accountability, political stability, government effectiveness, regulatory quality, the rule of law, and control over corruption. The authors controlled for physical, human, and macroeconomic factors that are known to affect FDI inflows. Drawing on panel data, the study revealed that regulatory quality had no effect on FDI inflows to the countries in question. Only four of the good governance indicators—namely political stability and the absence of violence, government effectiveness, the rule of law, and control over corruption—influenced FDI inflows. Mengistu and Adhikary therefore concluded that “a country which can enhance its governance environment in general is likely to attract more foreign direct investment despite offsetting deficiencies in other dimensions of good governance such as voice and accountability and regulatory quality.”

In 2015, Corcoran and Gillanders<sup>243</sup> investigated the relationship between the “business regulatory environment” of a country and the volume of FDI inflows that it attracts. They used aggregated EDB indicators as proxies for the business regulatory environment. The sample was split into three groups of countries: Sub-Saharan Africa, the OECD, and the rest of the world. The researchers used a cross-sectional approach to analyze the data on the determinants of FDI for the countries in the sample over the period 2004–2009. Their results indicate that the

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<sup>242</sup> Alemu Aye Mengistu & Bishnu Kumar Adhikary, *Does Good Governance Matter for FDI Inflows? Evidence From Asian Economies*, 17 ASIA PACIFIC BUSINESS REVIEW 281, 281–299 (2011).

<sup>243</sup> Adrian Corcoran & Robert Gillanders, *Foreign Direct Investment and the Ease of Doing Business*, 151 REV WORLD ECON 103, 103–126 (2015).

significant effect of the EDB indicators on FDI inflows was driven mainly by one indicator, trading across borders. The other indicators had little or no effect on FDI. Moreover, the researchers found that the business regulatory environment is a significant determinant of FDI inflows to middle-income countries, but not to Sub-Saharan African or OECD countries.

Jovanovic and Jovanovic (2017)<sup>244</sup> studied the relation between EDB indicators and FDI inflows in 27 former socialist OECD countries over the period 2004–2011. They used two econometric techniques, one classical (the generalized method of moments [GMM]) and one Bayesian, to test the relationship. Not all EDB indicators were shown to have an effect on FDI inflows. In fact, the authors pointed out that the effects of most indicators were insignificant or lacked robustness. Only three indicators had an effect. In the classical model, the ease of trading across borders and the ease of paying taxes were both significant. In the Bayesian analysis, the ease of trading across borders and that of enforcing contracts were significant. As a result, the authors concluded that only trade across borders could be shown to be a robust determinant of FDI in the sample countries.

In addition to local laws, IIAs can also facilitate business in host countries. Several studies have focused on the effect of bilateral investment treaties (BITs) on FDI inflows. As mentioned in Chapter 4, BITs attract FDI because the signatories assume reciprocal investor-protection obligations that encourage FDI and reduce uncertainty.<sup>245</sup> In fact, Elkins et al. (2006) noted that BITs “have become the most important international legal mechanism for the encouragement and governance of foreign direct investment.”<sup>246</sup> However, the results in the

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<sup>244</sup> Branimir Jovanovic & Biljana Jovanovic, *Ease of Doing Business and FDI in the Ex-Socialist Countries*, 15 INTERNATIONAL ECONOMICS AND ECONOMIC POLICY 587, 587–627 (2018).

<sup>245</sup> Mumtaz Hussain Shah, *Bilateral Investment Treaties and Multinational Investors: Evidence from FDI in the MENA States*, 12 PARADIGMS 94, 94-102 (2018).

<sup>246</sup> Zachary Elkins et al., *Competing for Capital: The Diffusion of Bilateral Investment Treaties 1960–2000*, 60 INTERNATIONAL ORGANIZATION 811, 811–846 (2006).

literature on the effectiveness of BITs in attracting FDI are inconsistent. Some studies have found a strong relationship between BITs and FDI, while others have not.

Salacuse and Sullivan (2005)<sup>247</sup> used cross-sectional analysis to examine whether there is a correlation between BITs and FDI inflows to developing countries. They found a strong association between the two. Neumayer and Spess (2005)<sup>248</sup> tested the effect of BITs that had been concluded between 20 developed and 119 developing countries on FDI inflows to developing countries between 1970 and 2001. Using panel data with two estimation techniques, a random-effects model and a fixed-effects model, the researchers concluded that developing countries that had signed BITs with developed countries attracted higher FDI inflows.

Shah (2018)<sup>249</sup> examined the relationship between BITs and FDI inflows to 20 MENA countries, including the six GCC countries, between 1990 and 2016. He used a panel random-effects analysis and also considered other FDI determinants (e.g., market size, development level measured by GDP per capita, trade openness, and macroeconomic stability). According to the results, BITs had a positive effect on FDI inflows to the MENA countries. Egger and Pfaffermayr (2004), Tobin and Rose-Ackerman (2006), and Egger and Merlo (2007) conducted similar studies and also found a positive correlation between BITs and FDI inflows.

Although many studies conclude that the relationship between BITs and FDI inflows is positive, some studies report nonsignificant results. For example, Hallward-Driemeier (2003)<sup>250</sup> conducted an empirical study to determine whether BITs affect FDI inflows from signatory to

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<sup>247</sup> Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and their Grand Bargain*, 46 *HARV. INT'L LJ* 67, 67–130 (2005).

<sup>248</sup> Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, 33 *WORLD DEVELOPMENT* 1567, 1567–1585 (2005).

<sup>249</sup> Mumtaz Hussain Shah, *Bilateral Investment Treaties and Multinational Investors: Evidence from FDI in the MENA States*, 12 *PARADIGMS* 94, 94-102 (2018).

<sup>250</sup> Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite* (World Bank Policy Research, Working Paper No. 3121, 2003).

developing countries. She found little evidence that BITs encourage investment; countries with weak institutions did not receive significant additional FDI inflows after signing BITs with developing countries. The author wrote, “[A] BIT has not acted as a substitute for broader domestic reform . . . BITs act as more of a complement than a substitute for domestic institutions, [meaning that] those [that] are benefiting from them are arguably the least in need of a BIT to signal the quality of their property rights.”<sup>251</sup>

Mina (2010)<sup>252</sup> specifically examined the correlation between BITs and FDI inflows to the six GCC countries between 1984 and 2002. He used panel data and a GMM estimation model. In his results, there was no significant relationship between the number of BITs that had been ratified by the GCC countries and FDI inflows.

### 3.2.2.2 Political Institutions

Beyond macroeconomic factors and business-facilitating legal institutions, political institutions can also shape the location decisions of MNEs and FDI inflows. Furthermore, political institutions serve to sustain business activity. The relevant factors of political institutions include political stability, corruption, and the protection of property rights, such as from expropriation. These factors can affect the sales of an MNE or cause harm to its property or personnel in host countries.<sup>253</sup> This study does not focus on political institutions and only treats the related factors as control variables.

A number of empirical studies have analyzed the relationship between political

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<sup>251</sup> Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite* (World Bank Policy Research, Working Paper No. 3121, 2003).

<sup>252</sup> Wasseem Mina, *Do Bilateral Investment Treaties Encourage FDI in the GCC Countries?*, 2 *AFRICAN REVIEW OF ECONOMICS AND FINANCE* 1, 1–29 (2010).

<sup>253</sup> IMAD A. MOSSA, *FOREIGN DIRECT INVESTMENT: THEORY, EVIDENCE AND PRACTICE* at 132 (2002) and Pravin Jadhav, *Determinants of Foreign Direct Investment in BRICS Economies: Analysis of Economic, Institutional and Political Factor*, 37 *PROCEDIA-SOCIAL AND BEHAVIORAL SCIENCES* 5, 5–14 (2012).

institutions and FDI inflows, with mixed results. Some studies—such as those of Dunning (1993),<sup>254</sup> Knack and Keefer (1995),<sup>255</sup> Gastanaga et al. (1998),<sup>256</sup> Wei (2000a, b),<sup>257</sup> Globerman and Shapiro (2002),<sup>258</sup> Jensen (2003),<sup>259</sup> Chan and Gemayel (2004),<sup>260</sup> Asiedu (2006),<sup>261</sup> Dupasquier and Osajwe (2006),<sup>262</sup> Busse and Hefeker (2007),<sup>263</sup> Benassy-Quere et al. (2007),<sup>264</sup> Al-Sadiq (2009),<sup>265</sup> Schneider and Matei (2010),<sup>266</sup> Mohamed and Sidiropoulos (2010),<sup>267</sup> Bissoon (2012),<sup>268</sup> Buchanan et al. (2012),<sup>269</sup> Nunes and Castro (2013),<sup>270</sup> and Elheddad (2016)<sup>271</sup>—report that political factors negatively affect investment decisions. Other studies—

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<sup>254</sup> JOHN H. DUNNING, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 267-286 (1<sup>st</sup> ed. 1993).

<sup>255</sup> Stephen Knack & Philip Keefer, *Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures*, 7 *ECONOMICS & POLITICS* 207, 207–227 (1995).

<sup>256</sup> Victor M. Gastanaga et al., *Host Country Reforms and FDI Inflows: How Much Difference Do They Make?*, 26 *WORLD DEVELOPMENT* 1299, 1299–1314 (1998).

<sup>257</sup> Shang-Jin Wei & Andrei Shleifer, *Local Corruption and Global Capital Flows*, 2000 *BROOKINGS PAPERS ON ECONOMIC ACTIVITY* 303, 303–354 (2000).

<sup>258</sup> Steven Globerman & Daniel Shapiro, *Global Foreign Direct Investment Flows: The Role of Governance Infrastructure*, 30 *WORLD DEVELOPMENT* 1899, 1899–1919 (2002).

<sup>259</sup> Nathan M. Jensen, *Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment*, 57 *INTERNATIONAL ORGANIZATION* 587, 587–616 (2003).

<sup>260</sup> Kitty K. Chan & Edward R. Gemayel, *Risk Instability and the Pattern of Foreign Direct Investment in the Middle East and North Africa Region* (International Monetary Fund, Working Paper No. 139, 2004).

<sup>261</sup> Elizabeth Asiedu, *Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability*, 29 *WORLD ECONOMY* 63, 63–77 (2006).

<sup>262</sup> Chantal Dupasquier & Patrick N. Osakwe, *Foreign Direct Investment in Africa: Performance, Challenges, and Responsibilities*, 17 *JOURNAL OF ASIAN ECONOMICS* 241, 241–260 (2006).

<sup>263</sup> Matthias Busse & Carsten Hefeker, *Political Risk, Institutions and Foreign Direct Investment*, 23 *EUROPEAN JOURNAL OF POLITICAL ECONOMY* 397, 397–415 (2007).

<sup>264</sup> Agnès Bénassy-Quéré et al., *Institutional Determinants of Foreign Direct Investment*, 30 *WORLD ECONOMY* 764, 764–782 (2007).

<sup>265</sup> Ali Al-Sadig, *The Effects of Corruption on FDI Inflows*, 29 *CATO JOURNAL* 267, 267–294 (2009).

<sup>266</sup> Hadjila Krifa-Schneider & Iuliana Matei, *Business Climate, Political Risk and FDI in Developing Countries: Evidence from Panel Data*, 2 *INTERNATIONAL JOURNAL OF ECONOMICS AND FINANCE* 54, 54–65 (2010).

<sup>267</sup> Sufian Eltayeb Mohamed & Moise G. Sidiropoulos, *Another Look at the Determinants of Foreign Direct Investment in MENA Countries: An Empirical Investigation*, 35 *JOURNAL OF ECONOMIC DEVELOPMENT* 75, 75–90 (2010).

<sup>268</sup> Ourvashi Bissoon, *Can Better Institutions Attract More Foreign Direct Investment (FDI)? Evidence from Developing Countries*, 11 *JOURNAL OF EUROPEAN ECONOMY* 38, 38–61 (2012).

<sup>269</sup> Bonnie G. Buchanan et al., *Foreign Direct Investment and Institutional Quality: Some Empirical Evidence*, 21 *INTERNATIONAL REVIEW OF FINANCIAL ANALYSIS* 81, 81–89 (2012).

<sup>270</sup> Conceição Castro & Pedro Nunes, *Does Corruption Inhibit Foreign Direct Investment?*, 51 *POLÍTICA. REVISTA DE CIENCIA POLÍTICA* 61, 61–83 (2013).

<sup>271</sup> Mohamed Mahjoub Elheddad, *Natural Resources and FDI in GCC Countries*, 6 *INTERNATIONAL JOURNAL OF BUSINESS AND SOCIAL RESEARCH* 12, 12–22 (2016).

including those by Wheeler and Mody (1992),<sup>272</sup> Nye (1979),<sup>273</sup> Wijeweera and Dollery (2009),<sup>274</sup> Jaspersen et al. (2000),<sup>275</sup> and Hausmann and Fernandez-Arias (2000)<sup>276</sup>— report that the relationship in question is either nonsignificant or positive.

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<sup>272</sup> David Wheeler & Ashoka Mody, *International Investment Location Decisions: The Case of US Firms*, 33 JOURNAL OF INTERNATIONAL ECONOMICS 57, 57–76 (1992).

<sup>273</sup> Joseph S. Nye, *Corruption and Political Development: A Cost-Benefit Analysis*, 61 AMERICAN POLITICAL SCIENCE REVIEW 417, 417–427 (1967).

<sup>274</sup> Albert Wijeweera & Brian Dollery, *Host Country Corruption Level and Foreign Direct Investments Inflows*, 2 INTERNATIONAL JOURNAL OF TRADE AND GLOBAL MARKETS 168, 168–178 (2009).

<sup>275</sup> Frederick Z. Jaspersen et al., *Risk and Private Investment: Africa Compared with Other Developing Areas*, in INVESTMENT AND RISK IN AFRICA at 71-95 (Paul Collier & Catherine Pattillo, 2000).

<sup>276</sup> Ricardo Hausmann & Eduardo Fernandez-Arias, *Foreign Direct Investment: Good Cholesterol?* (Inter-American Development Bank (IDB), Working Paper No. 417, 2000).

## Chapter 4. INTERNATIONAL INVESTMENT AGREEMENTS IN THE GCC

*This chapter explores IIAs in the GCC countries. As a source of FDI laws and regulations, these agreements are crucial to understanding the legal framework of FDI in the GCC. This chapter begins with an overview of IIAs. I subsequently discuss different types of IIAs. I focus in particular on BITs: their definition and importance, their history, their use in the GCC, their structure, and the relevant standards. I then turn to regional investment agreements and to economic integration agreements in the GCC.*

Prior to the middle of the 20<sup>th</sup> century, there was no international law or agreement regulating the dealings between states and investors. Furthermore, the customary rules of international law were insufficient because they were only applied in exceptional cases.<sup>277</sup> Thus, foreign investment was heavily regulated by domestic law. These domestic laws were not favorable to foreign investors because they allowed host states to change their foreign investment laws at any time, even after an investment was made. As states began to industrialize, the problem of domestic laws hostile to foreign investments became more widespread. IIAs emerged in order to address this problem. IIAs are designed to create a system of international law that protects both foreign investors and host countries, thereby increasing the overall volume of cross-border investments.

There are several types of IIAs. The most common are BITs, regional investment agreements, and economic integration investment agreements. The sections that follow provides

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<sup>277</sup> Surendra Bhandari, *Cross Border Investment, Trade and Impact on Revenue in the Context of the World Trade Organisation: A Case of Nepal* (2010) (manuscript), <https://ssrn.com/abstract=1682112>.

a brief overview of these agreements.

## 4.1 BILATERAL INVESTMENT TREATIES

### 4.1.1 *Definition and Importance*

BITs are the most important form of IIAs because they serve as the primary legal instruments that govern international investments. UNCTAD defines BITs as “agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other’s territories by companies based in either country.”<sup>278</sup> In other words, BITs are international treaties that protect investments by encouraging countries to collaborate and establish terms and conditions that are conducive to their mutual economic interests.

BITs are beneficial because they promote FDI while also establishing clear rules that protect foreign investors and investments within the host country.<sup>279</sup> As a result, BITs successfully mitigate the political risks that foreign investors face.<sup>280</sup> BITs are more effective than domestic laws for a number of reasons. One reason is that BITs work as commitment devices through which host countries undertake to protect foreign investors,<sup>281</sup> including their property rights,<sup>282</sup> as detailed later in this section. Furthermore, most BITs provide for

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<sup>278</sup> UNCTAD, *DEVELOPMENT AND GLOBALIZATION: FACTS AND FIGURES (2004)* and KENNETH A. REINERT, *AN INTRODUCTION TO INTERNATIONAL ECONOMICS NEW PERSPECTIVES ON THE WORLD ECONOMY* at 258 (2<sup>nd</sup> ed. 2020).

<sup>279</sup> UNCTAD, *BILATERAL INVESTMENT TREATIES IN THE MID-1990S* (1998).

<sup>280</sup> THOMAS POLLAN, *LEGAL FRAMEWORK FOR THE ADMISSION OF FDI* at 73 (2006) and ANDREW PAUL NEWCOMBE & LLUÍS PARADEL, *LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT* at 41 (2009) and Helena Sprenger & Bouke Boersma, *The Importance of Bilateral Investment Treaties (BITs) When Investing in Emerging Markets*, 2014 *BUS. L. TODAY* 1, 1–4 (2014).

<sup>281</sup> Suzanne Kirayoglu, *The Bilateral Investment Treaty: Its Origins and Effects* (2014) (Ph.D. dissertation, Florida State University) (ProQuest) and Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 *INTERNATIONAL REVIEW OF LAW AND ECONOMICS* 107, 107–123 (2005).

<sup>282</sup> Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite* (World Bank Policy Research, Working Paper No. 3121, 2003).

investment disputes to be resolved by neutral arbitrators rather than judges from the countries that are involved in the dispute. As discussed later in this section, this condition provides protection to investors because local courts can be biased in favor of the governments of their countries.<sup>283</sup> The next subsection outlines the history of BITs in order to explain how they operate in contemporary international law.

#### 4.1.2 *History*

At present, 2,896 BITs have been concluded between various countries, of which 2,335 are currently in force.<sup>284</sup> The first official BIT was concluded between Germany and Pakistan in 1959.<sup>285</sup> However, BITs have an even longer history. BITs developed out of friendship, commerce, and navigation (FCN) treaties.<sup>286</sup> These treaties are considered to be the precursors of BITs because they provided standards and principles that have been adopted into numerous contemporary BITs.<sup>287</sup> Some of the common standards that the authors of BITs have adopted from FCN treaties include national treatment, most-favorable-nation treatment, and alternative dispute resolution mechanisms.<sup>288</sup> These standards are discussed in more detail in Subsection 4.1.4.

FCN treaties were usually concluded by developed countries.<sup>289</sup> The first FCN treaty was the Treaty of Amity and Commerce, which was signed in 1778 by representatives of the US and France.<sup>290</sup> FCN treaties were bilateral treaties that facilitated investment across the signatory

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<sup>283</sup> *Id.*

<sup>284</sup> Investment Policy Hub, International Investment Agreements Navigator, <https://investmentpolicy.unctad.org/international-investment-agreements> (Last visited 12 Dec, 2021).

<sup>285</sup> THOMAS POLLAN, LEGAL FRAMEWORK FOR THE ADMISSION OF FDI at 70 (2006).

<sup>286</sup> M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT at 208 (2<sup>nd</sup> ed. 2004)

<sup>287</sup> *Id.* and THOMAS POLLAN, LEGAL FRAMEWORK FOR THE ADMISSION OF FDI at 71 (2006).

<sup>288</sup> M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT at 210 (2<sup>nd</sup> ed. 2004).

<sup>289</sup> William S. Dodge, *Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement*, 39 VAND. J. TRANSNAT'L L. 1, 1–37 (2006).

<sup>290</sup> John F. Coyle & Jason Webb Yackee, *Reviving the Treaty of Friendship: Enforcing International Investment Law in US Courts*, 49 ARIZ. ST. L.J. 61, 61–114 (2017).

states, but also contained provisions on trade, military matters, and the treatment and rights of aliens.<sup>291</sup>

After World War II, there was a need to create a multilateral agreement to regulate international trade and investment. The Havana Charter was an attempt to create such an agreement, but the attempt failed due to the refusal of the US to ratify the charter.<sup>292</sup> As a result, the General Agreement on Tariffs and Trade (GATT) was created to uniformly regulate international trade. For investment, however, *ad hoc* BITs emerged as a superior solution to broad multilateral agreements because they enabled parties to negotiate specific terms and obligations.

#### **4.1.3 Gulf Cooperation Council Bilateral Investment Treaties**

The GCC countries have signed 358 BITs<sup>293</sup> and ratified 239, of which 223 are currently in force. The remaining 16 have been terminated or replaced or are yet to come into force. Kuwait was the first GCC country to enter into a BIT, which was concluded with Iraq in 1964.<sup>294</sup> Among the GCC countries, the UAE has signed the largest number of BITs (108), followed by Kuwait (92), Qatar (62), Oman (38), Bahrain (33), and Saudi Arabia (25). It is worth noting that, unlike other MENA countries, the GCC states do not rely on BITs to promote investment.<sup>295</sup> One explanation is that GCC countries have large resource endowments, which makes compliance

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<sup>291</sup> M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* at 180 (2<sup>nd</sup> ed. 2004)

<sup>292</sup> Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U. C. DAVIS J. INT'L L. & POL'Y 157, 157–194 (2005) and M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* at 269 (2<sup>nd</sup> ed. 2004).

<sup>293</sup> Investment Policy Hub, International Investment Agreements Navigator, <https://investmentpolicy.unctad.org/international-investment-agreements/groupings/37/gcc-gulf-cooperation-council-> (Last visited 15 July, 2021).

<sup>294</sup> Investment Policy Hub, International Investment Agreements Navigator, <https://investmentpolicy.unctad.org/international-investment-agreements> (Last visited 12 Dec, 2021).

<sup>295</sup> Nassib G. Ziadé, *Arbitration Under MENA Regional Investment Treaties*, 83 *ARBITRATION: THE INTERNATIONAL JOURNAL OF ARBITRATION, MEDIATION AND DISPUTE MANAGEMENT* 48, 48–51 (2017) and *MENA-OECD INVESTMENT PROGRAMME*, OECD, *ASSESSING INVESTMENT POLICIES OF MEMBER COUNTRIES OF THE GULF COOPERATION COUNCIL* 54 (2011).

with BITs in the name of promoting investment less important than in other Middle Eastern countries.<sup>296</sup>

Table 4.1 below presents the number of GCC BITs that have been signed, ratified, terminated, and implemented.

**Table 4.1** *Bilateral investment treaties in Gulf Cooperation Council countries*

Country	Signed	Ratified	Currently in force	Signed (not in force)	Terminated
Bahrain	33	27	25	6	2
Kuwait	92	77	70	15	7
Oman	38	31	28	7	3
Qatar	62	28	27	34	1
Saudi Arabia	25	22	21	3	1
United Arab Emirates	108	58	56	50	2
Total	358	243	227	115	16

\*Calculated by the author on the basis of data from the Investment Policy Hub of the United Nations Conference on Trade and Development.

Researchers have used computational analytical tools to compare the BITs of GCC countries to those of the rest of the world.<sup>297</sup> The results show that the GCC countries are “champions of investment protections.”<sup>298</sup> GCC BITs provide above-average protection to foreign investors relative to the rest of the world. Kuwait and the UAE in particular provide more protection to foreign investors than the other GCC countries.<sup>299</sup>

<sup>296</sup> Nassib G. Ziadé, *Arbitration Under MENA Regional Investment Treaties*, 83 ARBITRATION: THE INTERNATIONAL JOURNAL OF ARBITRATION, MEDIATION AND DISPUTE MANAGEMENT 48, 48–51 (2017).

<sup>297</sup> Wolfgang Alschner et al., *Champions of Protection? A Text-As-Data Analysis of the Bilateral Investment Treaties of GCC Countries*, 2016 INTERNATIONAL REVIEW OF LAW 5 (2017).

<sup>298</sup> *Id.*

<sup>299</sup> *Id.*

#### 4.1.4

#### *Bilateral Investment Treaty Structure and Standards*

BITs are relatively short and contain few articles.<sup>300</sup> Over the years, the number of articles in BITs has gradually increased and BITs have become more complex.<sup>301</sup> The average BIT contains 14 articles.<sup>302</sup>

BITs, whatever their length, generally cover eight topics:<sup>303</sup> scope of application, conditions for the entry of foreign investment, general standards of treatment of foreign investment, operational conditions of the investment, protection against expropriation and dispossession, compensation for losses, monetary transfers, and investment dispute settlement. The following list items address each of those topics.

##### **1) Scope of Application**

Each BIT begins by stating that its purpose is the reciprocal encouragement and protection of investments, which both parties agree to provide.<sup>304</sup> Key terms in the treaty—such as “investor,” “investments,” “nationals,” “territory,” “contracting parties,” and “returns”—are also defined.

##### **2) Conditions for the Entry of Foreign Investment**

These provisions promote investment rather than creating legal obligations for the signatories—that is,<sup>305</sup> they function as “a ‘best efforts’ commitment of contracting parties”<sup>306</sup> to the procedure for entering the host country. The specifics might include the easing of visa and

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<sup>300</sup> URSULA KRIEBAUM ET AL., *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* at 16 (3<sup>rd</sup> ed., 2022).

<sup>301</sup> Wolfgang Alschner et al., *Champions of Protection? A Text-As-Data Analysis of the Bilateral Investment Treaties of GCC Countries*, 2016 *INTERNATIONAL REVIEW OF LAW* 5 (2017).

<sup>302</sup> *Id.*

<sup>303</sup> RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* at 58-66 (1<sup>st</sup> ed. 1995).

<sup>304</sup> M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* at 217 (2<sup>nd</sup> ed. 2004).

<sup>305</sup> KARL P SAUVANT & LISA E SACHS, *THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS* at 126 (2009).

<sup>306</sup> UNCTAD, *BILATERAL INVESTMENT TREATIES 1995-2006: TRENDS IN INVESTMENT RULEMAKING* (2007).

work permit restrictions for employees as well as reducing the number of approvals that are required for entry.<sup>307</sup>

### **3) General Standards of Treatment of Foreign Investments**

These provisions concern the treatment that the host country undertakes to afford to entering investors. This treatment can vary widely. It can be fair and equitable, national, or in line with the most-favored-nation principle. The parties can also opt for full protection-and-security treatment. Each type of treatment is discussed below.

#### **A) Fair and Equitable Treatment of Foreign Investors**

The host country may agree to grant fair and equitable treatment (FET) to investors regardless of its treatment of domestic businesses. Although FET is one of the most common standards,<sup>308</sup> not all countries include FET in their BITs. Saudi Arabian BITs provide several examples.<sup>309</sup> The emergence of the FET standard can be traced to 1948, when it was first mentioned in the Havana Charter for an International Trade Organization.<sup>310</sup> The same standard also appears in the Bogota Agreement (1948), the Abs-Shawcross Draft Convention on Investment Abroad (1959), the OECD Draft Convention on the Protection of Foreign Property (1963; 1967), the Draft UN Code of Conduct on Transnational Corporations (CTC; 1983), the MIGA Convention (1985), the ASEAN Treaty (1987), the Lomé IV (1990), the World Bank Guidelines (1992), the North American Free Trade Agreement (NAFTA) (1992), the Energy Charter Treaty (1994), the Colonial Protocol on Reciprocal Promotion and Protection of Investments within MERCOSUR (1994), the Pacific Basin Charter on International Investments

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<sup>307</sup> *Id.* and FIONA BEVERIDGE, GLOBALIZATION AND INTERNATIONAL INVESTMENT at 36 (2005).

<sup>308</sup> KENNETH J. VANDEVELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION at 190 (2010).

<sup>309</sup> OECD, INTERNATIONAL INVESTMENT LAW: A CHANGING LANDSCAPE at 78 (2005).

<sup>310</sup> MARTINS PAPARINSKIS, THE INTERNATIONAL MINIMUM STANDARD AND FAIR AND EQUITABLE TREATMENT at 90-91 (2013).

(1995), and the OECD Draft Negotiating Text for MAI (1998).<sup>311</sup>

It is worth noting that FET is the most commonly invoked investment standard.<sup>312</sup> Most successful claims in international arbitration are based on this standard.<sup>313</sup> Nevertheless, there is no agreement on its exact meaning. One commentator wrote the following:

The concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests. It is, therefore, a concept that depends on the interpretation of specific facts for its content. At most, it can be said that the concept connotes the principle of non-discrimination and proportionality in the treatment of foreign investors.<sup>314</sup>

Arbitral tribunals and scholars have subjected the FET standard to many different interpretations,<sup>315</sup> which has resulted in instability and uncertainty for investors. The standard was first taken to require a level of protection that is higher than the international law minimum.<sup>316</sup> The NAFTA Commission later issued an interpretative note that stated that the FET standard does not amount to more than the minimal protection that customary international law provides.<sup>317</sup>

To reduce confusion in the interpretation of FET, some BITs explicitly link the interpretation of FET to an acknowledged reference. For example, some BITs link the standard

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<sup>311</sup> OECD, Fair and Equitable Treatment Standard in International Investment Law (OECD Working Papers on International Investment, Working Paper No. 2004/03, 2004).

<sup>312</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW at 130 (2<sup>nd</sup> ed. 2012).

<sup>313</sup> *Id.*

<sup>314</sup> PETER MUCHLINSKI, MULTINATIONAL ENTERPRISES AND THE LAW at 625 (1995).

<sup>315</sup> PATRICK DUMBERRY, THE FORMATION AND IDENTIFICATION OF RULES OF CUSTOMARY INTERNATIONAL LAW IN INTERNATIONAL INVESTMENT LAW at 185 (2<sup>nd</sup> ed. 2018).

<sup>316</sup> M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT at 235-236 (2<sup>nd</sup> ed. 2004).

<sup>317</sup> *Id.*

to the minimum standard of treatment of aliens under customary international law.<sup>318</sup> An additional widespread approach to the FET standard is to link the interpretation of FET to additional substantive content, such as denial of justice, unreasonable or discriminatory measures, breach of other treaty obligations, or the level of development.<sup>319</sup> The Bahrain-US BIT of 1999 is a salient example. Article 2(3)(a) states that “[e]ach Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by international law.”<sup>320</sup>

## **B) National Treatment**

This standard requires the host state to treat foreign investors no less favorably than national investors. In other words, it gives foreign investors the same rights, privileges, concessions, and immunities that are granted to national investors. Depending on the BIT, this principle can apply after the foreign investor enters the market of the host country or during the pre-establishment period. In the latter case, the national treatment principle facilitates access to the market of the host state. Article 2(2) of the Saudi Arabia-Japan BIT that was signed in 2013 is a suitable example. That article states that “[o]nce admitted in accordance with its applicable legislation, each Contracting Party shall accord to investors of the other Contracting Party and to their investments treatment no less favorable than the treatment it accords in like circumstances to its own investors and their investments with respect to investment activities.”<sup>321</sup>

## **C) Most-Favored-Nation Treatment**

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<sup>318</sup> UNCTAD, FAIR AND EQUITABLE TREATMENT, UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS II (2012) and RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES at 58-60 (1<sup>st</sup> ed. 1995).

<sup>319</sup> UNCTAD, FAIR AND EQUITABLE TREATMENT, UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS II (2012).

<sup>320</sup> Bahrain–U.S. Bilateral Investment Agreement, Bahrain-U.S., Sept. 29, 1999 at *Art.* (2)(3)(a).

<sup>321</sup> Saudi Arabia–Japan Bilateral Investment Agreement, Saudi Arabia-Japan, Apr. 30, 2013 at *Art.* (2)(2).

The most-favored-nation standard was adopted from the old FCN treaties.<sup>322</sup> Under this standard, the host country extends the treatment that it grants to its most favored foreign investors to investors from the other signatory state. In other words, those investors can benefit from the favorable treatment that is afforded to nationals of third states. As a result, the host country does not discriminate between investors from different countries. Most-favored-nation treatment can also be combined with national treatment. Article 4(1) of the Singapore-Qatar BIT, which was signed in 2017, exemplifies this approach. The article states the following:

With respect to the management, maintenance, conduct, operation, and sale or other disposition of investments, each Contracting Party shall in its territory accord to investors of the other Contracting Party and their investments treatment no less favourable than that it accords, in like circumstances, to:

- (a) investors of any third State and their investments; or
- (b) its own investors and their investments,

whichever is more favourable.<sup>323</sup>

#### **D) Full Protection and Security Treatment**

Some treaties provide for “full protection and security” or “constant protection and security” for foreign investments. For example, Article 4(1) of the Austria-Saudi Arabia BIT that was signed in 2001 stipulates that “[i]nvestments by investors of either Contracting Party shall enjoy full protection and security in the territory of the other Contracting Party.” However, like FET, full protection and security is vaguely defined in most BITs. Arbitral tribunals have not held host countries responsible for harm to investments except when failure to exercise due diligence has been established. In this case, due diligence means “reasonable measures of prevention which a well administered government could be expected to exercise under similar

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<sup>322</sup> M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT at 236 (2<sup>nd</sup> ed. 2004).

<sup>323</sup> Singapore–Qatar Bilateral Investment Agreement, Singapore–Qatar, Oct. 17, 2017 at *Art.* (4)(1).

circumstances.” In other words, host countries are held liable when they fail to protect investments from harm that is reasonably foreseeable.

#### **4) Operational Conditions of the Investment**

Beyond the general treatment standards outlined on the preceding pages, some BITs also contain treatment standards for certain operational conditions.<sup>324</sup> The conditions in question include the right of the investor to enter the host country and to employ noncitizens.<sup>325</sup> For example, the Saudi-Japan BIT stipulates that “[e]ach Contracting Party shall, in accordance with its applicable legislation, give sympathetic consideration to applications for the entry, sojourn and residence of a natural person having the nationality of the other Contracting Party who wishes to enter the former Contracting Party and remain therein for the purpose of investment activities.”

#### **5) Protection Against Expropriation and Dispossession**

Expropriation is considered to be one of the gravest threats to foreign investors.<sup>326</sup> One of the most important securities that BITs grant to investors is therefore protection from expropriation (also known as taking, nationalization, deprivation, and dispossession)<sup>327</sup> and from other forms of interference with property rights on the part of the host country.<sup>328</sup> Expropriation occurs when the host state seizes the property of foreign investors for economic,<sup>329</sup> political,<sup>330</sup> and/or social

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<sup>324</sup> NORBERT HORN ET AL., *ARBITRATING FOREIGN INVESTMENT DISPUTES* at 103–104 (2004) and Jeswald W. Salacuse, *BIT by BIT: the Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *INTERNATIONAL LAWYER* 655 (1990).

<sup>325</sup> FIONA BEVERIDGE, *GLOBALIZATION AND INTERNATIONAL INVESTMENT* at 36 (2005).

<sup>326</sup> M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* at 239 (2<sup>nd</sup> ed. 2004) and RICHARD SCHAFFER ET AL., *INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT* at 559 (8<sup>th</sup> ed. 2012).

<sup>327</sup> ARTHUR W. ROVINE, *CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS* at 30 (2008).

<sup>328</sup> JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 150 (2<sup>nd</sup> ed., 2015).

<sup>329</sup> See RICHARD SCHAFFER ET AL., *INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT* at 559 (8<sup>th</sup> ed. 2012).

<sup>330</sup> See *Id.*

reasons.<sup>331</sup> For example, land that is owned by a foreign private entity may be seized in the public interest to build railways or bridges.

BITs balance the right of states to advance the public interest and the property rights of foreign investors by subjecting the expropriation of foreign-owned property to conditions. The following restrictions are common:<sup>332</sup>

- (a) the property must be taken for a public purpose,
- (b) the expropriation must be non-discriminatory,
- (c) the expropriation must accord with due process of law, and
- (d) the expropriation must be accompanied by compensation.

When expropriation occurs, prompt, adequate, and effective compensation<sup>333</sup> must be provided (the Hull Formula).<sup>334</sup>

In addition, many BITs broaden the definition of expropriation to include indirect expropriation. Indirect expropriation occurs when “a state takes effective control of, or otherwise interferes with the use, enjoyment or benefit of, an investment, strongly depreciating its economic value, even without a direct taking of property.”<sup>335</sup> This definition includes creeping expropriations, which occur when the state passes new regulations or changes laws in a way that reduces the value of foreign investments. New charges and tax increases are salient examples. Most BITs protect investors from expropriation and equivalent measures. For example, Article 6(1) of the Mexico-UAE BIT (2016) states that “[n]either Contracting Party may expropriate or

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<sup>331</sup> *See Id.*

<sup>332</sup> Kenneth J. Vandeveld, *The Political Economy of a Bilateral Investment Treaty*, 92 THE AMERICAN JOURNAL OF INTERNATIONAL LAW 621, 631 (1998).

<sup>333</sup> *Id.*

<sup>334</sup> KARL P SAUVANT & LISA E SACHS, THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS at 130 (2009).

<sup>335</sup> UNCTAD, EXPORTATION (2012).

*nationalize an investment either directly or indirectly through measures tantamount to expropriation or nationalization*”<sup>336</sup> The article lists exceptions to this rule, as mentioned in the discussion of restrictions on expropriation above.

## **6) Compensation for Losses**

Most BITs address losses from civil disturbances in the host country, such as wars, riots, and revolutions. In such cases, most BITs oblige the host country to compensate the investors who are harmed. The amount of compensation, however, is difficult to determine. Countries negotiate compensation mechanisms when they conclude BITs. Those mechanisms can take different forms, and compensation can be tied to the position of national investors or the most-favored-nation treatment.<sup>337</sup> For example, Article 4(2) of the Saudi Arabia-Turkey BIT that was signed in 2006 is worded as follows:<sup>338</sup>

Investors of either Contracting Party who suffer losses in the territory of the other Contracting Party owing to war or other armed conflict, revolution, or revolt, or other similar events shall be accorded by such other Contracting Party treatment not less favorable than that accorded to its own investors or to investors of any third country, whichever is the most favorable treatment, as regards to restitution; indemnification, compensation or other valuable consideration if accepted by the investor. Such payments shall be freely transferable. The legality of any such expropriation, nationalization or comparable measure and the amount of compensation shall be subject to review by due process of law.

## **7) Monetary Transfers**

Money transfers include but are not limited to the transfer of returns on investments, loan repayments, funds from the liquidation of assets, and reinvestment. Money transfers cause

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<sup>336</sup> Mexico–United Arab Emirates Bilateral Investment Agreement, Mexico–United Arab Emirates, Jan. 19, 2016 at *Art. (6)(1)*.

<sup>337</sup> ANTHONY AUST, *HANDBOOK OF INTERNATIONAL LAW* at 349 (2<sup>nd</sup> ed., 2010) and Jeswald W. Salacuse, *BIT by BIT: the Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *INTERNATIONAL LAWYER* 655, 672 (1990).

<sup>338</sup> Saudi Arabia–Turkey Bilateral Investment Agreement, Saudi Arabia–Turkey, Aug. 8, 2006 at *Art. (4)(2)*.

concern for both investors and host states. Investors and capital-exporting countries prefer that money is freely transferrable.<sup>339</sup> To achieve this classification, three conditions must be met: it must be possible to transfer profits and funds in and out of the host country at market exchange rates,<sup>340</sup> without delay,<sup>341</sup> and in a freely convertible currency.<sup>342</sup> At the same time, the host state, especially if it is a developing country, seeks to retain some control over its currency and to enact its national policies by using reserve capital from outflows.<sup>343</sup> This option is exceedingly important for countries with chronic balance-of-payment issues.<sup>344</sup> Therefore, monetary transfer provisions in BITs are often the most difficult to negotiate.<sup>345</sup> However, they are rarely disputed because they are usually sufficiently detailed and leave no room for misinterpretation.<sup>346</sup>

Most BITs stipulate that money should be freely transferrable in order to promote investment. A balance is struck in some BITs through the inclusion of an article that enables the host country to suspend transfers in cases of chronic balance-of-payment issues. For example, Article 8(1) of the Singapore-Qatar BIT, which was signed in 2017, stipulates the following:<sup>347</sup>

In the event of serious balance of payments and external financial difficulties or threat thereof, a Contracting Party may adopt or maintain restrictions on payments or transfers related to investments. It is implemented that particular pressures on the balance of payments of a Contracting Party in the process of economic development may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development.

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<sup>339</sup> Jeswald W. Salacuse, *BIT by BIT: the Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *INTERNATIONAL LAWYER* 655, 668–669 (1990).

<sup>340</sup> Suzanne Kirayoglu, *The Bilateral Investment Treaty: Its Origins and Effects* (2014) (Ph.D. dissertation, Florida State University) (ProQuest).

<sup>341</sup> See KENNETH J. VANDEVELDE, *BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION* at 316–324 (2010).

<sup>342</sup> *Id.*

<sup>343</sup> FIONA BEVERIDGE, *GLOBALIZATION AND INTERNATIONAL INVESTMENT* at 38–39 (2005).

<sup>344</sup> *Id.*

<sup>345</sup> Jeswald W. Salacuse, *BIT by BIT: the Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *INTERNATIONAL LAWYER* 655, 668–669 (1990).

<sup>346</sup> JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 285 (2<sup>nd</sup> ed., 2015).

<sup>347</sup> Singapore–Qatar Bilateral Investment Agreement, Singapore–Qatar, Oct. 17, 2017 at *Art.* (8)(1).

## 8) Investment Dispute Resolution

International investment disputes tend to be resolved by the courts of host countries.

However, several risks are associated with this tendency, especially in disputes between investors and host countries. These risks include i) bias in favor of the state,<sup>348</sup> ii) a lack of domestic judicial expertise in complex issues of international law,<sup>349</sup> iii) inefficient and time-consuming domestic procedural systems,<sup>350</sup> iv) poor enforcement of court decisions by the executive branch even if decisions favor the foreign investor,<sup>351</sup> and v) local laws that restrict the justiciability of international commitments.<sup>352</sup>

For these reasons, assigning exclusive jurisdiction over international investment disputes to domestic courts is unattractive. Therefore, BITs provide for access to alternative dispute resolution mechanisms. Most BITs grant the aggrieved party the ability to bring claims for breach of the investment agreement before an international arbitration panel. BITs usually contain two dispute resolution clauses. One addresses disputes between the contracting parties (state-state disputes), and the other addresses disputes between investors and the host state (investor-state disputes).

State-state disputes are usually resolved through negotiations between diplomats.<sup>353</sup> If the two states fail to reach an agreement within a specified period, then most BITs allow the harmed state to bring a claim for a violation of international law in *ad hoc* arbitration.<sup>354</sup> For example, Article 15(2) of the Kuwait-Japan BIT stipulates that “[a]ny dispute between the Contracting Parties as to

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<sup>348</sup> See NORBERT HORN ET AL., *ARBITRATING FOREIGN INVESTMENT DISPUTES* at 103–104 (2004) and RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* at 234 (2<sup>nd</sup> ed. 2012).

<sup>349</sup> JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 397 (2<sup>nd</sup> ed., 2015).

<sup>350</sup> See NORBERT HORN ET AL., *ARBITRATING FOREIGN INVESTMENT DISPUTES* at 103–104 (2004).

<sup>351</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* at 234 (2<sup>nd</sup> ed. 2012).

<sup>352</sup> *Id.* and JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 397 (2<sup>nd</sup> ed., 2015).

<sup>353</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* at 232–234 (2<sup>nd</sup> ed. 2012); see also JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 152 (2<sup>nd</sup> ed., 2015).

<sup>354</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* at 234 (2<sup>nd</sup> ed. 2012); see also JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 152 (2<sup>nd</sup> ed., 2015).

*the interpretation or application of this Agreement, not satisfactorily adjusted by diplomacy within six months, shall be referred for decision to an arbitral tribunal.”*

The second type of dispute settlement clause in BITs addresses investor-state disputes. Such clauses should determine the type of arbitration, which can be *ad hoc* or institutional. As far as *ad hoc* arbitration is concerned, the parties must agree, through the BIT, on the procedural rules that govern the dispute as well as on the choice of arbitrators and the applicable law.<sup>355</sup> If the parties choose institutional arbitration, then an institution facilitates the arbitration and provides them with administrative support. In both cases, the parties can choose the substantive law that governs the dispute and a set of procedural rules, such as those developed by the International Centre for Settlement of Investment Disputes (ICSID) or UNCITRAL.

It is worth mentioning that parties can choose any commercial arbitration institution. The institution need not specialize in international investment disputes. For example, an investment dispute can be settled by the International Chamber of Commerce or the London Court of International Arbitration. However, most BITs refer to the ICSID.

The ICSID is associated with the World Bank and was established by the Washington Convention of 1965,<sup>356</sup> which entered into force in 1966. It is the leading arbitration institution for international investment disputes, to which access is granted to member states and their nationals.<sup>357</sup> The ICSID has 163 member states, including the six GCC countries. The first GCC country to become a member of the ICSID was Kuwait in 1979, followed by Saudi Arabia in 1980, the UAE in

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<sup>355</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* at 238 (2<sup>nd</sup> ed. 2012).

<sup>356</sup> KENNETH J. VANDEVELDE, *BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION* at 431 (2010).

<sup>357</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270; 575 U.N.T.S. 159 at *Art.* (1)(2).

1982, Oman in 1995, Bahrain in 1996, and Qatar in 2011. Notably, some countries with large economies— such as Brazil, India, and South Africa—are not members of the ICSID.<sup>358</sup>

The creation of the ICSID was an attempt to harmonize procedural rules in investor-state arbitration and to provide administrative support to parties. However, the ICSID does not have dedicated arbitrators. Instead, the parties must hire their own. The decisions of those arbitrators are binding and final. The parties cannot appeal against awards, except in limited cases that are specified in the ICSID Convention.<sup>359</sup> Furthermore, the parties are free to choose the applicable substantive law. They may elect to rely on the national laws of the contracting parties or on the UNCITRAL rules. In the absence of such an agreement, the arbitrators apply the law of the host state.<sup>360</sup>

However, not all disputes can be arbitrated before the ICSID. Member states can propose to exclude certain international investment disputes from arbitration at any time. Saudi Arabia, for example, excludes disputes that are related to oil or to exercises of its sovereign prerogatives from arbitration.

The first BIT to refer to the ICSID as an arbitration institution for investor-state disputes was the Netherlands-Indonesia BIT of 1968. Since then, a growing number of BITs have come to refer to the ICSID as a dispute resolution mechanism. However, it was not until 1990 that the ICSID heard its first investor-state dispute.<sup>361</sup>

The GCC countries have defended few claims before the ICSID. There have been no rulings against GCC countries to date. Some cases were resolved in favor of the GCC country, others were

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<sup>358</sup> CRINA BALTAG, *ICSID CONVENTION AFTER 50 YEARS UNSETTLED ISSUES* (2017).

<sup>359</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270; 575 U.N.T.S. 159 at *Art.* (53).

<sup>360</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270; 575 U.N.T.S. 159 at *Art.* (42)(1).

<sup>361</sup> *Asian Agri. Prod. Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3 (Final Award, June 27, 1990) and NATHALIE BERNASCONI-OSTERWALDER, *INT’L INST. FOR SUSTAINABLE DEV., STATE-STATE DISPUTE SETTLEMENT IN INVESTMENT TREATIES* (2014).

settled, and others were discontinued. Table 4.2 presents a summary of cases against the GCC countries before the ICSID.<sup>362</sup>

**Table 4.2** *Summary of Gulf Cooperation Council cases at the International Centre for Settlement of Investment Disputes*

<b>State</b>	<b>Total Number of Cases</b>
<b>Bahrain</b>	1
<b>Kuwait</b>	6
<b>Oman</b>	3
<b>Qatar</b>	1
<b>Saudi Arabia</b>	6
<b>The United Arab Emirates</b>	4

## 4.2 REGIONAL INVESTMENT AGREEMENTS

Regional investment agreements (RIA) are the second most common type of IIAs, after BITs.<sup>363</sup> RIAs are defined as binding multilateral agreements between states within a geographical area.<sup>364</sup> Due to the lack of a universal multilateral investment agreement and substantive rules on foreign investments, RIAs came into existence to facilitate economic cooperation between neighboring countries that exhibit economic, political, religious,<sup>365</sup> and linguistic similarities.

The GCC countries have entered into two main RIAs: the Unified Agreement for the Investment of Arab Capital in the Arab States and the Agreement on Promoting, Protection, and

<sup>362</sup> For details of all cases before the ICSID that had GCC states as respondents see Cases, ICSID, <https://icsid.worldbank.org/cases/case-database> (last visited July 15, 2022).

<sup>363</sup> THOMAS POLLAN, LEGAL FRAMEWORK FOR THE ADMISSION OF FDI at 85 (2006).

<sup>364</sup> See MAURICE W. SCHIFF & L. ALAN WINTERS, REGIONAL INTEGRATION AND DEVELOPMENT at 1-2 (2003).

<sup>365</sup> THOMAS POLLAN, LEGAL FRAMEWORK FOR THE ADMISSION OF FDI at 85 (2006).

Guarantee of Investment among the Member States of the Organization of the Islamic Conference. These treaties are detailed in the subsections.

#### **4.2.1** *The Unified Agreement for the Investment of Arab Capital in the Arab States*

The Unified Agreement for the Investment of Arab Capital in the Arab States, also known as the Arab Investment Agreement (AIA), is an important investment agreement concluded by the Arab countries.<sup>366</sup> It was signed during the 11<sup>th</sup> Arab Summit Conference in Amman, Jordan, on November 26, 1980,<sup>367</sup> and was amended in 2013.<sup>368</sup> All of the GCC countries are signatories, as are the member states of the Arab League (with the exception of Algeria and the Union of Comoros).<sup>369</sup> The agreement was designed to strengthen Arab economic integration by<sup>370</sup> 1) encouraging wealthy nations in the region to invest in poorer ones<sup>371</sup> and by 2) providing Arab investors with protection from expropriation.<sup>372</sup>

Like most investment treaties, the agreement includes some investor-protection standards, including national treatment,<sup>373</sup> protection against expropriation (except in very limited circumstances),<sup>374</sup> and compensation for harm resulting from civil disturbance and internal disorder.<sup>375</sup>

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<sup>366</sup> THOMAS POLLAN, *LEGAL FRAMEWORK FOR THE ADMISSION OF FDI* at 120 (2006).

<sup>367</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980).

<sup>368</sup> Amended Unified Agreement for the Investment of Arab Capital in the Arab States (2013).

<sup>369</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980).

<sup>370</sup> See Walid Ben. Hamida, *The First Arab Investment Court Decision*, 7 *THE JOURNAL OF WORLD INVESTMENT & TRADE* 699, 699–721 (2006).

<sup>371</sup> JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* at 107 (2<sup>nd</sup> ed., 2015).

<sup>372</sup> *Id.*

<sup>373</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (5).

<sup>374</sup> *Id.* at *Art.* (9).

<sup>375</sup> *Id.* at *Art.* (10).

However, the original agreement of 1980 lacked several important standards that are usually included in agreements of this type.<sup>376</sup> For example, it did not provide for full protection and security or FET.<sup>377</sup> It also restricted the duration of the guarantee of capital transfers to the home country to either five years from the time of the inward transfer to the host country<sup>378</sup> or until the time when an investment matures.<sup>379</sup> If the two periods were different, the shorter one would apply. Moreover, under the original agreement, only those investments that were wholly owned by a national of a signatory state could benefit from the rules of the treaty.<sup>380</sup> In other words, if a corporation was partially owned by a national of a non-signatory state, the agreement would not apply.

The 2013 amendment resolved many of these problems. The amendment introduced the principle of FET for Arab investors.<sup>381</sup> The limitations on capital transfers were removed.<sup>382</sup> Moreover, the scope of the amended agreement is broader than the original: it applies to investments in which a national of a signatory state holds at least a 51% share,<sup>383</sup> rather than only in cases of full ownership as in the original agreement.<sup>384</sup>

The AIA, in Chapter IV, established the Arab Investment Court. This court has jurisdiction over investment disputes that arise from the AIA unless the parties agree to use other

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<sup>376</sup> OECD, *THE 2013 AMENDMENT TO THE 1980 ARAB LEAGUE INVESTMENT AGREEMENT: A STEP TOWARDS IMPROVING THE REGION'S ATTRACTIVENESS TO INVESTORS* (2014).

<sup>377</sup> *Id.*

<sup>378</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (7)(2). *See also*, Amr Arafa Hasaan, *The 2013 Amendments to the Arab Investment Agreement*, 34 *ICSID REVIEW-FOREIGN INVESTMENT LAW JOURNAL* 107, 107-135 (2019).

<sup>379</sup> *Id.*

<sup>380</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (1)(5).

<sup>381</sup> Amended Unified Agreement for the Investment of Arab Capital in the Arab States (2013) *Art.* (2).

<sup>382</sup> *Id.* at *Art.* (6).

<sup>383</sup> *Id.* at *Art.* (1)(8) and OECD, *THE 2013 AMENDMENT TO THE 1980 ARAB LEAGUE INVESTMENT AGREEMENT: A STEP TOWARDS IMPROVING THE REGION'S ATTRACTIVENESS TO INVESTORS* (2014).

<sup>384</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (1)(5).

mechanisms,<sup>385</sup> such as conciliation or arbitration.<sup>386</sup> It also has jurisdiction over AIA disputes if an arbitration award is not enforced within three months of the date of its issuance.<sup>387</sup> The AIA also offers investors the right to refer their dispute to the domestic courts of the host country.<sup>388</sup> However, if they choose to do so, they lose their right to initiate legal action before the Arab Investment Court.<sup>389</sup>

The Arab Investment Court has at least five full-time serving judges, each of a different Arab nationality.<sup>390</sup> Moreover, the judges who hear a dispute must not be of the same nationality as either of the parties. The court's judgments are final and cannot be appealed.<sup>391</sup> While the court was established in 1985, it did not hear its first case until 2003.<sup>392</sup>

#### **4.2.2** *Agreement on Promotion, Protection, and Guarantee of Investment Among Member States of the Organization of the Islamic Conference*

The second regional investment treaty that is important for the GCC countries is the Agreement on Promotion, Protection and Guarantee of Investment among Member States of the Organization of the Islamic Conference, which is also known as the OIC Investment Agreement. This agreement was established by the Organization of Islamic Cooperation (OIC), an intergovernmental organization with 57 Muslim member states, which was established in 1969 in Rabat, Morocco. The OIC is the second largest intergovernmental organization after the United

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<sup>385</sup> See John Gaffney, The EU proposal for an Investment Court System: What Lessons Can be Learned from the Arab Investment Court? (Columbia FDI Perspectives, Paper No. 181, 2016) and Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (29).

<sup>386</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (25).

<sup>387</sup> *Id.* Annex *Art.* (2)(11).

<sup>388</sup> Unified Agreement for the Investment of Arab Capital in the Arab States (1980) *Art.* (31).

<sup>389</sup> *Id.* at *Art.* (31).

<sup>390</sup> *Id.* at *Art.* (28).

<sup>391</sup> *Id.* at *Art.* (34).

<sup>392</sup> Walid Ben. Hamida, *The First Arab Investment Court Decision*, 7 THE JOURNAL OF WORLD INVESTMENT & TRADE 699, 699–721 (2006) and *Tanmiah v. Tunisia*, Arab Investment Court, Case No. 1/1 Q, IIC 238 (2004), October 12, 2004, Arab League.

Nations.<sup>393</sup> One of its objectives, which is mentioned in Article 1 of its Charter, is “*to strengthen intra-Islamic economic and trade cooperation; in order to achieve economic integration leading to the establishment of an Islamic Common Market.*”<sup>394</sup>

The OIC adopted the OIC Investment Agreement in 1981 in order to strengthen economic cooperation between its member states. However, the agreement did not enter into force until 1988. It has been signed by 36 member states, including all six GCC countries, and has been ratified by 29.<sup>395</sup> Although the agreement was drafted four decades ago, the first case founded upon the OIC Investment Agreement was heard in 2013.<sup>396</sup>

The OIC Investment Agreement provides for basic guarantees and protections for investors from member states. These include free monetary transfers,<sup>397</sup> favorable entry procedures,<sup>398</sup> most-favored-nation treatment,<sup>399</sup> protection from expropriation,<sup>400</sup> compensation for damage resulting from internal disorder,<sup>401</sup> and the right to choose arbitration as a dispute settlement mechanism.<sup>402</sup> Moreover, the agreement gives the contracting states the right to agree to more preferential treatment than the standard it provides.<sup>403</sup> The OIC Agreement does not provide for FET or national treatment of foreign investors except in cases that involve compensation for losses that result from civil disturbance and internal disorder.

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<sup>393</sup> Walid Ben Hamida, *A Fabulous Discovery: The Arbitration Offer under the Organization of Islamic Cooperation Agreement Related to Investment*, 30 JOURNAL OF INTERNATIONAL ARBITRATION 637, 638 (2013).

<sup>394</sup> Charter of the Organization of Islamic Cooperation (1974) Art. (1)(9).

<sup>395</sup> Investment Policy Hub, OIC (Organisation of Islamic Cooperation), <https://investmentpolicy.unctad.org/international-investment-agreements/groupings/45/oic-organisation-of-islamic-cooperation-> (Last visited Feb. 18, 2020).

<sup>396</sup> See *Hesham T. M. Al-Warraq v. Republic of Indonesia*, UNCITRAL (Final Award, December 15, 2004).

<sup>397</sup> Agreement for Promotion, Protection and Guarantee of Investment Among Member States of the Organization of the Islamic Conference (1981) Art. (2) and (11).

<sup>398</sup> *Id.* at Art. (5).

<sup>399</sup> *Id.* at Art. (8).

<sup>400</sup> *Id.* at Art. (10).

<sup>401</sup> *Id.* at Art. (13).

<sup>402</sup> *Id.* at Art. (17).

<sup>403</sup> *Id.* at Art. (18).

### 4.3 ECONOMIC INTEGRATION INVESTMENT AGREEMENTS

Economic integration agreements (EIAs) “facilitate international trade and cross-border movements of the factors of production.”<sup>404</sup> Contracting states have recently begun introducing investment clauses into EIAs. EIAs that include investment-related provisions are called economic integration investment agreements (EIIAs).<sup>405</sup> EIIAs can take different forms, including free trade agreements (FTAs), preferential trade agreements, RIAs, partnership and cooperation agreements, association agreements, economic partnership agreements, and framework agreements on trade and investment relations.

The following subsections address the most significant EIIAs that have been concluded by the GCC states. The first subsection addresses intraregional EIIAs between the GCC countries, while the second subsection addresses extraregional EIIAs.

#### 4.3.1 *Gulf Cooperation Council Intra-Regional Economic Integration Investment Agreements*

One of the most important objectives of the GCC at its inception was to strengthen economic integration between its six member states.<sup>406</sup> Therefore, in 1981, the members of the GCC signed the Unified Economic Agreement (UEA). This agreement is arguably the second most important document for the GCC member states, after the GCC Charter.<sup>407</sup> The agreement introduced four sequentially ordered initiatives to foster intensive economic integration.<sup>408</sup> It

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<sup>404</sup> UNCTAD, INVESTMENT PROVISIONS IN ECONOMIC INTEGRATION AGREEMENTS (2006).

<sup>405</sup> *Id.*

<sup>406</sup> See Robert Looney, *The Gulf Co-Operation Council's Cautious Approach to Economic Integration*, 24 JOURNAL OF ECONOMIC COOPERATION 137, 138 (2003).

<sup>407</sup> Charter of the Gulf Cooperation Council (GCC), May 25, 1981, 1288 UNTS 151 and Abdul Aziz Mohammed Al Hinai, *Regional Integration and the Gulf Cooperation Council: An Assessment of the Trade Provisions of the Unified Economic Agreement at 9* (2004) (Ph.D. dissertation, The Claremont Graduate University) (ProQuest).

<sup>408</sup> Nasser Al-Mawali, *Intra-Gulf Cooperation Council: Saudi Arabia Effect*, 30 JOURNAL OF ECONOMIC INTEGRATION 532, 538 (2015).

requires the GCC member states to establish FTAs, a customs union, a common market, and finally, a monetary union. Since the signing of the UEA, the GCC countries have established an FTA and a customs union. However, full economic integration through the formation of a monetary union is yet to be achieved. The GCC FTA and the customs union are discussed in detail in the following paragraphs.

#### **4.3.1.1 Gulf Cooperation Council Free Trade Agreements**

In 1983, the GCC countries concluded the GCC FTA. This agreement made the movement of capital and labor across the GCC states easier and removed customs duties on products that originate from the GCC.<sup>409</sup> According to the UEA, the customs union had to be formed within five years of the establishment of the FTA.<sup>410</sup> However, due to disagreements on external tariffs, the negotiations lasted for more than two decades.<sup>411</sup> In 2003, the GCC FTA was replaced by a customs union because the EU refused to lower trade barriers placed until such a union was in place.<sup>412</sup> The GCC countries agreed to impose a uniform 5% tariff on products from countries outside of the GCC and formed a customs union.<sup>413</sup>

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<sup>409</sup> The Unified Economic Agreement between the Countries of the Gulf Cooperation Council (1981) *Art.* (8).

<sup>410</sup> *Id.* at *Art.* (4)(3).

<sup>411</sup> Abdul Aziz Mohammed Al Hinai, *Regional Integration and the Gulf Cooperation Council: An Assessment of the Trade Provisions of the Unified Economic Agreement at 9* (2004) (Ph.D. dissertation, The Claremont Graduate University) (ProQuest).

<sup>412</sup> Adriana Kalicka-Mikołajczyk, *Towards a New Comprehensive Partnership-Economic and Trade Relations Between the Gulf Cooperation Council and the European Union*, 5 *WROCLAW REVIEW OF LAW, ADMINISTRATION & ECONOMICS* 18, 21 (2015) and Abdul Aziz Mohammed Al Hinai, *Regional Integration and the Gulf Cooperation Council: An Assessment of the Trade Provisions of the Unified Economic Agreement at 9* (2004) (Ph.D. dissertation, The Claremont Graduate University) (ProQuest).

<sup>413</sup> Robert Looney, *The Gulf Co-Operation Council's Cautious Approach to Economic Integration*, 24 *JOURNAL OF ECONOMIC COOPERATION* 137, 140 (2003).

#### 4.3.1.2 Gulf Cooperation Council Customs Union

The GCC customs union removed all restrictions on the movement of goods between member countries.<sup>414</sup> In other words, the GCC countries do not discriminate between goods of different origins, regardless of whether they are from the GCC countries, as long as those goods circulate within the territory of the GCC.<sup>415</sup> The members of the union are also required to collectively negotiate EIAs with non-GCC-member countries.<sup>416</sup> There are two exceptions to this rule,<sup>417</sup> the Bahrain-US FTA and the US-Oman FTA, which are later discussed in detail.

The investment-related articles of the UEA require the GCC member states to unify and harmonize rules and regulations. Article 21 of the UEA states that “*Member States shall seek to unify investment rules and regulations in order to achieve a joint investment policy aimed at directing their domestic and foreign investments towards serving their interest, and realizing their people’s aspirations for development and progress.*”<sup>418</sup> In adherence to this rule, the GCC countries have signed and negotiated several EIAs as a group. However, the domestic investment laws of the GCC countries have not yet been harmonized, a point to which this study returns in Chapter 5.

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<sup>414</sup> Nasser Al-Mawali, *Intra-Gulf Cooperation Council: Saudi Arabia Effect*, 30 JOURNAL OF ECONOMIC INTEGRATION 532, 538 (2015) and Adriana Kalicka-Mikołajczyk, *Towards a New Comprehensive Partnership-Economic and Trade Relations Between the Gulf Cooperation Council and the European Union*, 5 WROCLAW REVIEW OF LAW, ADMINISTRATION & ECONOMICS 18, 21-22 (2015).

<sup>415</sup> *Id.*

<sup>416</sup> The Unified Economic Agreement between the Countries of the Gulf Cooperation Council (1981) *Art.* (7).

<sup>417</sup> Habib Kazzi, *Is the Gulf Cooperation Council (GCC) Customs Union a Myth?*, 5 ASIAN JOURNAL OF BUSINESS AND MANAGEMENT 150, 150–156 (2017).

<sup>418</sup> The Unified Economic Agreement between the Countries of the Gulf Cooperation Council (1981) *Art.* (21) and Habib Kazzi, *Is the Gulf Cooperation Council (GCC) Customs Union a Myth?*, 5 ASIAN JOURNAL OF BUSINESS AND MANAGEMENT 150, 150–156 (2017).

#### 4.3.2

### *Gulf Cooperation Council Extraregional Economic Integration Investment Agreements*

The remaining EIAs involving GCC countries are extraregional, which means that these agreements were concluded between GCC member states and non-member states. These agreements take various forms, such as FTAs and framework agreements on economic cooperation. I discuss the agreements in question in the paragraphs that follow.

#### **4.3.2.1 Free Trade Agreements With Investment-Related Provisions**

FTAs are governed by international law. The contracting states agree to engage in international trade and to lower or eliminate tariff and non-tariff barriers on exports and imports.<sup>419</sup> FTAs can be one of the following types: unilateral,<sup>420</sup> in which one of the contracting states enjoys fewer restrictions than the other;<sup>421</sup> bilateral,<sup>422</sup> in which both contracting states enjoy fewer restrictions;<sup>423</sup> and multilateral,<sup>424</sup> in which more than two countries enter into an agreement to lower trade barriers.<sup>425</sup> The first FTA was the Cobden-Chevalier Treaty of 1860, which was concluded by the UK and France.<sup>426</sup> Today, NAFTA has produced the largest free trade area in the world.

There are two types of FTAs in the GCC countries. Individual GCC states may enter into an FTA with another country (country-country FTAs). Alternatively, the GCC as a group may

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<sup>419</sup> RICHARD SCHAFFER ET AL., *INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT* at 262 (8th ed. 2012).

<sup>420</sup> ANNE VAN DE HEETKAMP & RUUD TUSVELD, *ORIGIN MANAGEMENT: RULES OF ORIGIN IN FREE TRADE AGREEMENTS* at 35 (2011)

<sup>421</sup> *Id.*

<sup>422</sup> *Id.* at 35–36.

<sup>423</sup> *Id.*

<sup>424</sup> *Id.*

<sup>425</sup> *Id.*

<sup>426</sup> See LILLIAN CORBIN & MARK PERRY, *FREE TRADE AGREEMENTS: HEGEMONY OR HARMONY* at 1–7 (2018) and CHARLES LIPSON & BENJAMIN J. COHEN, *THEORY AND STRUCTURE IN INTERNATIONAL POLITICAL ECONOMY: AN INTERNATIONAL ORGANIZATION READER* at 294 (1999).

conclude an FTA with a country or with another union (group-state or group-group FTAs). I discuss both types of agreement below.

#### **4.3.2.1.1 Country-country Free Trade Agreements of the Gulf Cooperation Council**

As previously noted, under the GCC customs union rules, GCC countries can only enter into EIAs as a group.<sup>427</sup> This means that an individual GCC state cannot enter into an FTA. There are two exceptions to this rule, the US-Bahrain FTA and the US-Oman FTA. These FTAs with the US were concluded with a view to advancing a more ambitious project, the Middle East Free Trade Area (MEFTA). That project was initiated in 2003, during the Bush administration. It aimed to strengthen economic ties between the US and Middle Eastern countries.<sup>428</sup> The US set six conditions for a Middle Eastern country to become a part of the MEFTA:<sup>429</sup> the country had to be a member of the World Trade Organization (WTO),<sup>430</sup> adopt a generalized system of preferences,<sup>431</sup> enter into a trade and investment framework agreement with the US,<sup>432</sup> establish BITs with the US,<sup>433</sup> enter into an FTA with the US,<sup>434</sup> and, finally, to join the Middle East Partnership Initiative.<sup>435</sup> The project was slotted for completion by 2013. However, at the end of the Bush presidency, the Obama administration did not proceed with the project, which consequently failed.<sup>436</sup>

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<sup>427</sup> Habib Kazzi, *Is the Gulf Cooperation Council (GCC) Customs Union a Myth?*, 5 ASIAN JOURNAL OF BUSINESS AND MANAGEMENT 150, 150–156 (2017).

<sup>428</sup> MARY J. BOLLE, CONG. RSCH. SERV., RL32638, MIDDLE EAST FREE TRADE AREA: PROGRESS REPORT (2005) and Bessma Momani, *A Middle East Free Trade Area: Economic Interdependence and Peace Considered*, 30 WORLD ECONOMY 1682, 1682–1700 (2007).

<sup>429</sup> MARY J. BOLLE, CONG. RSCH. SERV., RL32638, MIDDLE EAST FREE TRADE AREA: PROGRESS REPORT (2005).

<sup>430</sup> *Id.*

<sup>431</sup> *Id.*

<sup>432</sup> *Id.*

<sup>433</sup> *Id.*

<sup>434</sup> *Id.*

<sup>435</sup> *Id.*

<sup>436</sup> *Id.*

As the MEFTA was taking shape, the US began entering into FTAs with Middle Eastern countries. The first Middle Eastern country to sign an FTA with the US was Jordan in 2001.<sup>437</sup> Bahrain became the first GCC country to conclude an FTA with the US in 2006,<sup>438</sup> followed by Oman in 2009.<sup>439</sup> Those agreements raised two concerns. First, as mentioned above, under the GCC customs union rules, GCC member states can only sign FTAs as part of a collective effort with the other GCC countries.<sup>440</sup> When Bahrain concluded its agreement with the US, it arguably violated the UEA. However, the Bahraini agreement with the US was justified by the WTO Treaty, which prohibits restrictions on FTAs.<sup>441</sup> Second, the aforementioned agreements granted the US preferential market access to the GCC. For example, U.S. products enjoyed duty-free access to the markets of the signatory countries, and the GCC countries in question could export U.S. imports to other GCC countries without tariffs, as per the GCC customs union agreement.<sup>442</sup>

The US-Bahrain FTA was based on the U.S. model FTA, which resembles the NAFTA. It also shares similarities with the US-Jordan FTA. The conclusion of the US-Bahrain FTA indicates that the domestic business laws of Bahrain meet U.S. standards. However, even though the FTA eliminated several trade barriers, it did not facilitate investment between the two states to any considerable extent, as the focus of the agreement is on trade. Bahrain is the only GCC

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<sup>437</sup> David Price, *Built Upon Shifting Sands—Warning Signs for the United States’ Middle East Free Trade Area Strategy*, 4 INTERNATIONAL REVIEW OF BUSINESS RESEARCH PAPERS 231, 235 (2008) and Demic Tipitino, *Do Bilateral FTAs Increase Trade? Case Study: Oman, Bahrain, and their US-FTAs* (2011) (Ph.D. dissertation, University of Oregon) (on file with author).

<sup>438</sup> David Price, *Built Upon Shifting Sands—Warning Signs for the United States’ Middle East Free Trade Area Strategy*, 4 INTERNATIONAL REVIEW OF BUSINESS RESEARCH PAPERS 231, 236 (2008) and Demic Tipitino, *Do Bilateral FTAs Increase Trade? Case Study: Oman, Bahrain, and their US-FTAs* (2011) (Ph.D. dissertation, University of Oregon) (on file with author).

<sup>439</sup> David Price, *Built Upon Shifting Sands—Warning Signs for the United States’ Middle East Free Trade Area Strategy*, 4 INTERNATIONAL REVIEW OF BUSINESS RESEARCH PAPERS 231, 237 (2008) and Demic Tipitino, *Do Bilateral FTAs Increase Trade? Case Study: Oman, Bahrain, and their US-FTAs* (2011) (Ph.D. dissertation, University of Oregon) (on file with author).

<sup>440</sup> The Unified Economic Agreement between the Countries of the Gulf Cooperation Council (1981) *Art.* (7).

<sup>441</sup> Bashar H. Malkawi, *Legal Architecture and Design for Gulf Cooperation Council Economic Integration*, 36 JOURNAL FOR JURIDICAL SCIENCE 58, 41 (2011).

<sup>442</sup> *Id.* at 39.

country that has concluded a BIT with the US, which explains why the FTA does not focus on investment, unlike the US-Oman FTA.

The US-Oman FTA was signed in 2006 and came into force in January 2009.<sup>443</sup> In addition to eliminating most of the tariff and non-tariff barriers between the two contracting states,<sup>444</sup> the US-Oman FTA also regulates investments. Chapter 10 of the FTA contains standards that are typical for most BITs, including national treatment,<sup>445</sup> most-favored-nation treatment,<sup>446</sup> and FET.<sup>447</sup> It also protects investors from expropriation<sup>448</sup> and obliges the host state to compensate investors who are harmed by armed conflict or civil strife in the host state.<sup>449</sup> Furthermore, Chapter 10 provides for alternative dispute resolution when disagreements arise between investors and one of the contracting states.<sup>450</sup>

#### **4.3.2.1.2 Group-Group and Group-State Free Trade Agreements**

The GCC countries can also collectively conclude FTAs with other countries or other groups of countries. The GCC-Lebanon FTA of 2004, the GCC-Singapore FTA of 2008, and the GCC-European Free Trade Association (an interregional agreement) of 2009 are salient examples. However, only the Singapore FTA was in force as of 2013. The other two FTAs were signed, but not yet in force. Moreover, none of the three FTAs regulate investment. Therefore, they are considered EIAs, not EIIAs.

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<sup>443</sup> See generally MARY JANE BOLLE, CONG. RSCH. SERV., RL33328, U.S.–OMAN FREE TRADE AGREEMENT (2006).

<sup>444</sup> *Id.*

<sup>445</sup> U.S.-Oman Free Trade Agreement, U.S.-Oman, Jan. 19, 2006 at *Art.* (2.2).

<sup>446</sup> *Id.* at *Art.* (10.4)

<sup>447</sup> *Id.* at *Art.* (10.5).

<sup>448</sup> *Id.* at *Art.* (10.6).

<sup>449</sup> *Id.* at *Art.* (10.5)(4).

<sup>450</sup> *Id.* at *Art.* (10.14)–(10.16).

### 4.3.2.2 Framework Agreement on Economic Cooperation

The GCC has entered into framework agreements on economic cooperation with three countries: Peru, the US, and India. However, none of those treaties are currently in force. Table 4.3 presents the EIAs discussed in this section.

**Table 4.3** *Summary of the GCC EIAs*

Type of EIIA	Name	Status	Parties	Date of Signing	Date of entry in force
GCC Intraregional EIAs	The Unified Economic Agreement between the Countries of the GCC	In force	GCC countries	11/11/1981	01/12/1981
GCC Extraregional EIAs	GCC-EFTA FTA	Signed (not in force)	EFTA (European Free Trade Association)	22/06/2009	N/A
	Bahrain-US FTA	In force	US	14/09/2004	11/01/2006
	Oman-US FTA	In force	US	19/01/2006	1/01/2009
	GCC-Lebanon FTA	Signed (not in force)	Lebanon	11/05/2004	N/A
	GCC-Singapore FTA	In force	Singapore	15/12/2008	01/09/2013
	GCC-European FTA	Signed (not in force)	EU	2009	N/A
Framework Agreement on Economic Cooperation	GCC-Peru Framework Agreement	Signed (not in force)	Peru	01/10/2012	N/A
	GCC-US Framework Agreement	Signed (not in force)	US	25/09/2012	N/A
	GCC-India Framework Agreement	Signed (not in force)	India	25/08/2004	N/A

## **Chapter 5. FDI LEGAL FRAMEWORK IN THE GCC COUNTRIES**

*This chapter discusses the second sub-question of this dissertation, which concerns the legal frameworks that govern FDI in the six GCC countries. The chapter discusses the historical development of FDI laws and regulations in each GCC country. It then compares current FDI laws and regulations on the basis of nine parameters, namely 1) the foreign ownership of capital, 2) the form of the legal entity of the foreign investor, 3) the national treatment principle, 4) the corporate tax regime, 5) tariff and customs duty exemptions, 6) the transferability of capital and earnings, 7) the time and expense associated with starting a business, 8) real estate ownership, and 9) free trade zones.*

### **5.1 HISTORICAL DEVELOPMENT OF FOREIGN DIRECT INVESTMENT LAWS AND REGULATIONS IN THE GULF COOPERATION COUNCIL COUNTRIES**

This section discusses the historical development of FDI laws and regulations in each GCC country.

#### **5.1.1 *Bahrain***

Bahrain is the only GCC country that has not enacted specific laws to regulate and organize FDI. In Bahrain, FDI is primarily regulated by the Commercial Companies Law. The paragraphs below discuss the legal framework that governs FDI in Bahrain.

##### **5.1.1.1 Foreign Ownership of Capital**

As a general matter, Bahrain allows 100% foreign capital ownership, except in certain sectors. The current list of sectors and activities into which investments by non-Bahraini entities are prohibited, known as the “negative list,” includes real estate services and the rental and management of land and buildings (not including the sale and purchase of real property or the

management and development of private property);<sup>451</sup> daily, non-daily, and specialized newspapers and magazines;<sup>452</sup> the operation of printing presses;<sup>453</sup> and the supply of foreign manpower.<sup>454</sup> It is worth noting that GCC country nationals and U.S. citizens are treated in the same way as Bahrainis.<sup>455</sup> As a result, investors from these countries are not prohibited from engaging in activities on the negative list.

In several sectors and activities, there is a requirement of 51% Bahraini ownership.<sup>456</sup> These sectors are tourism;<sup>457</sup> the generation, transfer, and distribution of electricity;<sup>458</sup> the manufacture of lighting gas;<sup>459</sup> the delivery of steam fuel and air conditioning;<sup>460</sup> the operation of internet cafes;<sup>461</sup> accountancy and tax consultation;<sup>462</sup> civil aviation;<sup>463</sup> the collection of purified water and the delivery of water;<sup>464</sup> and the sale of home fuel, charcoal, and gas.<sup>465</sup> Even though GCC and U.S. nationals benefit from national treatment, they must fulfill the requirement of 51% Bahraini ownership if they wish to engage in these activities.

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<sup>451</sup> Specifying the Activities Permitted to be Carried Out by Companies with Foreign Capital in Bahrain, Decision No. (40) of 2021 (Aug. 05, 2021).

<sup>452</sup> *Id.*

<sup>453</sup> *Id.*

<sup>454</sup> *Id.*

<sup>455</sup> The Ministry of Industry and Commerce Kingdom of Bahrain, Procedures Guide for Establishments and Commercial Companies, <https://www.moic.gov.bh/en/Tiles/BusinessServices/Commercial%20Registration%20and%20Companies%20Control/Documents/Procedures%20Guide%20for%20Establishments%20and%20Commercial%20Companies.pdf> (last visited July 15, 2022) *and* Ratifying the Free Trade Agreement between the Government of the Kingdom of Bahrain and the Government of the United States of America, Law No. (23) for the year 2005 (July 20, 2005) *and* Ratification of the First Protocol to amending the Free Trade Agreement Government of the Kingdom of Bahrain and the Government of the United States of America, Law No. (28) For the year 2010 (June 30, 2010) *and* Ratification the Second Protocol to amend the Free Trade Agreement between the Government of the Kingdom of Bahrain and the Government of the United States of America, Law No. (11) For the year 2016 (May 25, 2016).

<sup>456</sup> Permitting Companies with Foreign Capital to Practice Certain Commercial Activities in Bahrain, Resolution No. (50) of 2016 (Oct. 6, 2016).

<sup>457</sup> *Id.*

<sup>458</sup> *Id.*

<sup>459</sup> *Id.*

<sup>460</sup> *Id.*

<sup>461</sup> *Id.*

<sup>462</sup> *Id.*

<sup>463</sup> *Id.*

<sup>464</sup> *Id.*

<sup>465</sup> *Id.*

The law may also allow non-Bahrainis to establish businesses without ownership restrictions. Article 345 of the Bahraini Commercial Companies Law states that “it may be permissible to establish companies as provided in this law to be owned partially or wholly by non-Bahraini Partners to carry our activities which are exclusively licensed for Bahraini’s, or activities that non-Bahraini cannot carry out without having a Bahraini partner owns the majority of the shares in the company, to carry our any of those activities according to the company’s share capital or the jurisdictions chosen as the location of the company’s head quarter to conduct its business.”<sup>466</sup>

### 5.1.1.2 Form of the Legal Entity

The Bahraini legislature does not require foreign investment companies to adopt any particular form.<sup>467</sup> Therefore, foreign investors in Bahrain can use any of the following legal forms that are permissible under the Commercial Companies Law: a general partnership company,<sup>468</sup> a limited partnership company,<sup>469</sup> an association in participation,<sup>470</sup> a joint-stock company,<sup>471</sup> a partnership limited by shares,<sup>472</sup> a limited liability company,<sup>473</sup> a single-person company,<sup>474</sup> and a holding company.<sup>475</sup> The Bahraini legislature also allows foreign companies to maintain branches and agency offices in Bahrain.<sup>476</sup>

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<sup>466</sup> Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *Art.* (345).

<sup>467</sup> *See* Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *and* the Ministry of Industry, Commerce and Tourism Kingdom of Bahrain, Procedures Guide for Establishments and Commercial Companies,

<https://www.moic.gov.bh/en/Tiles/BusinessServices/Commercial%20Registration%20and%20Companies%20Control/Guidelines/Documents/amended%20Procedures%20Guide%20for%20Establishments%20and%20Commercial%20Companies%20%28002%29.pdf> (last visited Nov. 25, 2021).

<sup>468</sup> Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *Art.* (2).

<sup>469</sup> *Id.*

<sup>470</sup> *Id.*

<sup>471</sup> *Id.*

<sup>472</sup> *Id.*

<sup>473</sup> *Id.*

<sup>474</sup> *Id.*

<sup>475</sup> *Id.*

<sup>476</sup> Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *Art.* (347) *and* (348).

### 5.1.1.3 National Treatment

The Bahraini legislature does not explicitly grant national treatment to foreign investors. In fact, Article 4 of the Bahraini Companies Law indicates that “[a]ny company incorporated in Bahrain shall be domiciled therein, and shall be of Bahraini Nationality without necessarily being entitled to the rights exclusive to Bahrainis.”<sup>477</sup>

### 5.1.1.4 Tax

Bahrain does not impose corporate taxes on companies, whether they are national or foreign. However, companies that engage in the exploration, production, or refining of oil and hydrocarbons are subject to a 46% corporate tax.<sup>478</sup>

### 5.1.1.5 Tariff and Customs Duty Exemptions

Bahrain offers no special tariff or customs exemptions to foreign investors. National and foreign investors are treated in the same way. Customs duties in Bahrain are generally set at 5% of the value of an import.<sup>479</sup> There are exceptions for alcohol, cigarettes, and paper and aluminum products, which are subject to customs duties of 125%,<sup>480</sup> 100%,<sup>481</sup> and 20%, respectively.<sup>482</sup> Machinery and raw materials are exempt from customs duties.

### 5.1.1.6 Transferability of Capital and Earnings

The Bahraini legislature does not restrict the transfer of foreign capital. The same share transfer rules apply to Bahraini and non-Bahraini nationals. Before 2014, there was an exception for foreign shares in joint-stock companies. In that case, the law prohibited the foreign

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<sup>477</sup> Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *Art.* (4).

<sup>478</sup> Bahrain Income Tax Law, Decree Law No. (22) of 1979 (Nov. 28, 1979) *Art.* (2).

<sup>479</sup> The International Trade Administration, Bahrain-Country Commercial Guide, <https://www.trade.gov/country-commercial-guides/bahrain-trade-barriers> (last visited Aug 14, 2022).

<sup>480</sup> *Id.*

<sup>481</sup> *Id.*

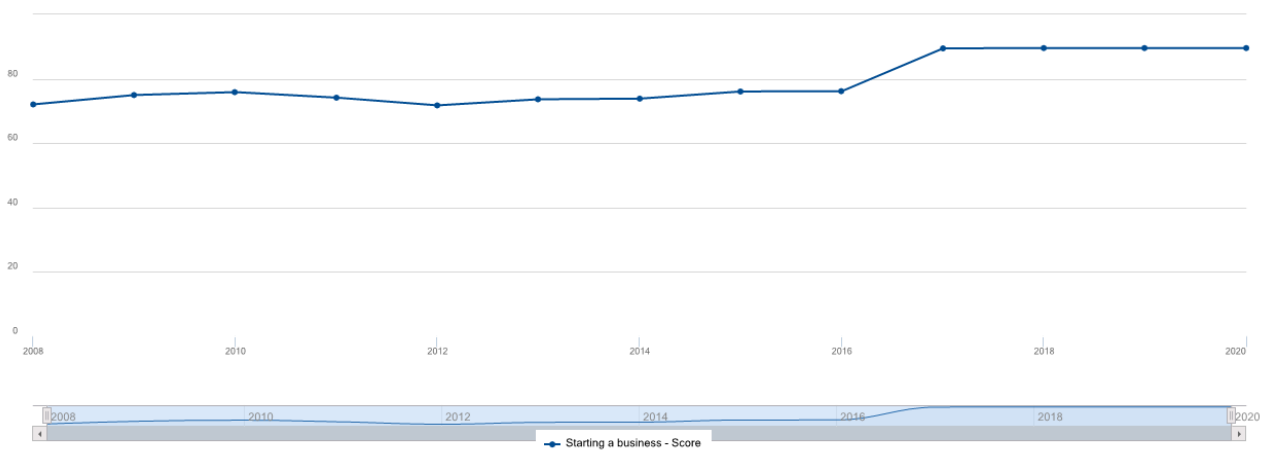
<sup>482</sup> *Id.*

shareholder from transferring their shares for a period of three years after the date of incorporation of the company unless the transaction was between the founding foreign partners.<sup>483</sup> However, this restriction was removed in 2014.<sup>484</sup> Moreover, the Bahraini legislature does not restrict the repatriation of capital, profit, or dividends.

### 5.1.1.7 Starting a Business

In the most recent EDB report, Bahrain earned a score of 89.6 out of 100 for the ease of starting a business.<sup>485</sup> That score is based on time and cost. Figure 5.1 below illustrates Bahrain’s score for the ease of starting a business between 2008 and 2020.

**Figure 5.1** *Ease of starting a business in Bahrain*



Country : Bahrain  
Source: Doing Business  
Created on: 07/18/2022

<sup>483</sup> Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *Art.* (65).

<sup>484</sup> Amendment No. (50) of 2014 with Respect to Bahrain Commercial Companies Law No. (21) of 2001 (Sept. 18, 2014).

<sup>485</sup> Starting a Business, Doing Business, <https://archive.doingbusiness.org/en/data/exploretopics/starting-a-business> (last visited July 15, 2022).

### 5.1.1.8 Ownership of Real Estate

Bahrain allows non-Bahrainis, whether natural or legal persons, to own real estate.<sup>486</sup>

However, the Bahraini government restricts foreign ownership of real estate to certain areas.<sup>487</sup>

### 5.1.1.9 Free Trade Zones

At the time of writing, Bahrain has three free trade zones: the Bahrain Logistics Zone,<sup>488</sup> the Bahrain International Investment Park,<sup>489</sup> and Bahrain International Airport. Given that Bahrain has relaxed regulations and rules to ease onshore trade and investment, the free trade zones in Bahrain do not differ much in regulation from the rest of the country. The regulations in question include those on full foreign ownership of company capital,<sup>490</sup> zero corporate and personal income tax,<sup>491</sup> zero customs duties,<sup>492</sup> and the unrestricted repatriation of capital, profit, and dividends.<sup>493</sup>

## 5.1.2 *Kuwait*

Kuwait has passed two sets of laws to regulate FDI. The first was passed in 2001 as part of the 2035 economic diversification plan.<sup>494</sup> However, the 2001 law exhibited certain shortcomings and did not facilitate foreign investment. In 2013, the Kuwaiti legislature therefore passed a second FDI law.<sup>495</sup> The following paragraphs describe the legal framework that governs

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<sup>486</sup> Non-Bahraini Ownership of Real Estate and Lands in the Kingdom of Bahrain, Legislative Decree No. (67) of 2006 (Dec. 13<sup>th</sup>, 2006) *Art.* (1).

<sup>487</sup> *Id.*

<sup>488</sup> See Ministry of Transportation and Telecommunications, Bahrain Logistics Zone, <https://www.mtt.gov.bh/content/pma-bahrain-logistics-zone> (last visited Nov. 19, 2021).

<sup>489</sup> See Bahrain International Investment Park, <https://www.biip.com.bh/incentives> (last visited Nov. 19, 2021).

<sup>490</sup> See Ministry of Transportation and Telecommunications, Bahrain Logistics Zone, <https://www.mtt.gov.bh/content/pma-bahrain-logistics-zone> (last visited Nov. 19, 2021) and Bahrain International Investment Park, <https://www.biip.com.bh/incentives> (last visited Nov. 19, 2021).

<sup>491</sup> *Id.*

<sup>492</sup> *Id.*

<sup>493</sup> *Id.*

<sup>494</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001).

<sup>495</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013).

FDI in Kuwait by reference to both the 2001 and the 2013 law as well as to other laws and regulations.

### 5.1.2.1 Foreign Ownership of Capital

Before the passage of the new FDI law, Kuwaiti regulations restricted foreigners to owning a maximum of 49% of the capital of an enterprise. The Kuwaiti Commercial Law also stipulated that non-Kuwaitis could not practice any commercial activity in Kuwait unless they had one or more Kuwaiti partners,<sup>496</sup> who had to own at least 51% of the capital of the enterprise.<sup>497</sup>

The new FDI law removed the limit on foreign ownership; foreigners can now own 100% of the capital of a company.<sup>498</sup> However, foreign investors are prohibited from practicing certain activities. The most recent negative list contains 10 such activities, which are as follows:

- the extraction of crude petroleum;
- the extraction of natural gas;
- the manufacture of coke oven products;
- the manufacture of fertilizers or nitrogenous compounds;
- the manufacture of gas and the distribution of gaseous fuels through main pipelines;
- real estate, excluding privately operated development projects;
- security and investigative activities;
- public administration, defense, and compulsory social security;
- membership organizations; and
- recruitment, including the recruitment of domestic workers.<sup>499</sup>

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<sup>496</sup> Kuwait Commercial Code, Act No. (68) of 1980 (Oct. 15, 1980) *Art.* (23).

<sup>497</sup> *Id.*

<sup>498</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (12) and Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art.* (8).

<sup>499</sup> The List of Excluded Direct Investments from the Provisions of Law No. (116) of 2013 regarding the Promotion of Direct Investment in the State of Kuwait, Council of Ministers Decision No. (75) of 2015.

### 5.1.2.2 Form of the Legal Entity

The old law did not restrict the forms of enterprise that foreign investors could establish in Kuwait. Such companies could take any of the forms that are permissible under the Kuwaiti Commercial Companies Law as long as the enterprise met the requirement of 51% Kuwaiti ownership.<sup>500</sup> Moreover, the old regulations prohibited foreign companies from establishing branches in Kuwait without recruiting a Kuwaiti agent.<sup>501</sup> Article 24 of the Commercial Code stated that a non-Kuwaiti company could not establish branches in Kuwait or engage in commercial activities in the country except through a local agent.<sup>502</sup>

The new Kuwaiti FDI law allows a wholly foreign-owned enterprise to take the form of a shareholding company,<sup>503</sup> a limited liability company,<sup>504</sup> or a single-person company.<sup>505</sup> However, if the enterprise is partially owned by foreigners, it can take any one of the forms that are permissible under the Commercial Companies Law: general partnership company,<sup>506</sup> limited partnership company,<sup>507</sup> partnership limited by shares,<sup>508</sup> joint venture company,<sup>509</sup> shareholding company,<sup>510</sup> limited liability company,<sup>511</sup> and single-person company.<sup>512</sup>

Furthermore, unlike the old law, the new FDI law allows foreign investors to establish branches and representative offices without a Kuwaiti national agent.<sup>513</sup> However, representative

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<sup>500</sup> See Kuwait Companies Law, Law No. (15) of 1960 (May 12, 1960) *Art.* (68).

<sup>501</sup> Kuwait Commercial Code, Act No. (68) of 1980 (Oct. 15, 1980) *Art.* (24).

<sup>502</sup> *Id.*

<sup>503</sup> Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art.* (8).

<sup>504</sup> *Id.*

<sup>505</sup> *Id.*

<sup>506</sup> Kuwait Companies Law, Law No. (15) of 2017 amending provisions of Law No. (1) of 2016 on the Promulgation of the Companies Law (Apr. 26, 2017) *Art.* (4).

<sup>507</sup> *Id.*

<sup>508</sup> *Id.*

<sup>509</sup> *Id.*

<sup>510</sup> *Id.*

<sup>511</sup> *Id.*

<sup>512</sup> *Id.*

<sup>513</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (12).

offices are only permitted to prepare market studies and production plans.<sup>514</sup> In other words, the law prohibits representative offices from engaging in commerce or commercial agency.<sup>515</sup>

### 5.1.2.3 National Treatment

Neither the old nor the new Kuwaiti FDI law indicate whether foreign enterprises may benefit from national treatment. However, the Companies Law states that companies established in Kuwait are deemed to be Kuwaiti nationals and are domiciled in Kuwait.<sup>516</sup>

### 5.1.2.4 Tax

The old Kuwaiti FDI Law did not grant automatic tax exemptions to foreign investors. Instead, it left such decisions to the discretion of the Kuwaiti Investment Committee. Article 13 of the old FDI Law stated that “[t]he Investment Committee *may* grant foreign investments all or part of the following privileges ... Exemption from income tax or any other taxes for a period *not exceeding ten years* from starting the actual operation of the enterprise as well as exempting every new investment in the same enterprise from such taxes for a period equivalent to that granted to the original investment when the enterprise was established.”<sup>517</sup> Therefore, under the old Kuwaiti FDI law, the Kuwaiti Investment Committee could grant a 10-year tax holiday to foreign investors.

The new Kuwaiti FDI law, by comparison, gives foreign investors a corporate tax holiday of up to 10 years. Article 27 of that law states that “[t]he Investor *shall be* entitled to some or all of the following incentives.”<sup>518</sup> The incentives in question include all types of tax exemptions.

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<sup>514</sup> *Id.*

<sup>515</sup> *Id.*

<sup>516</sup> Kuwait Companies Law, Law No. (15) of 2017 amending provisions of Law No. (1) of 2016 on the Promulgation of the Companies Law (Apr. 26, 2017) *Art.* (23).

<sup>517</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art.* (13).

<sup>518</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art.* (27).

The article reads as follows: “Exemption from income tax or any other taxes for a period not exceeding ten years from the date of the actual commencement of operations of the licensed investment entity.”<sup>519</sup>

#### 5.1.2.5 Tariff and Customs Duty Exemptions

The old Kuwaiti FDI law listed several privileges that the Investment Committee could grant to foreign investors. One of these privileges was a total or partial exemption from customs duties on specific imports in the following categories:

- 1) machinery, equipment, and spare parts required for construction, expansion, and development, and
- 2) raw materials, semi-processed goods, wrapping and packaging materials, and other such materials that are required for production purposes.<sup>520</sup>

Therefore, under the old law, the Investment Committee had considerable discretion to decide whether an exemption would be granted and whether it would be complete or partial. Moreover, the law did not specify the duration of the exemption.

The new FDI law slightly modified this regime. Article 27 of the Executive Regulations that implement the new law states that “[t]he Investment Entity *shall be* fully or partially exempted from customs duties and taxes.”<sup>521</sup> Exemptions from customs duties may last for up to 10 years.<sup>522</sup> The article refers to some imports that are subject to the exemption, but does not provide an exhaustive list, a change from the previous framework. The list includes the following items:

- 1) machinery, tools, equipment, means of transport, and other technological devices,

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<sup>519</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art.* (27)(1).

<sup>520</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art.* (13).

<sup>521</sup> Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art.* (27).

<sup>522</sup> Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art.* (32).

- 2) spare parts and supplies necessary for the maintenance of the devices listed in the preceding subsection, and
- 3) intermediate goods, raw materials, partially manufactured goods, and wrapping and packaging materials and supplies.<sup>523</sup>

Moreover, the Kuwaiti legislature attaches conditions to the grant of customs exemptions. In this way, Kuwait is unique among the GCC states. The conditions are that 1) the entity must import goods under its own name or for its own account<sup>524</sup> and that 2) the imports must be in the quantity and of the quality that are necessary for the activities of the entity.<sup>525</sup>

#### **5.1.2.6 Transferability of Capital and Earnings**

Before the passage of the new FDI law, there were no restrictions on the transfer of foreign capital. Foreign investors could transfer their shares in full or in part to national or foreign investors.<sup>526</sup> Moreover, the law permitted foreign investors to repatriate their profits, capital, and remuneration.<sup>527</sup> The law also explicitly allowed non-Kuwaiti employees to repatriate entitlements and savings.<sup>528</sup>

The new Kuwaiti FDI law also does not place restrictions on the transfer of foreign capital to nationals or foreign investors. According to Article 20 of the new Kuwaiti FDI law, “The Investor has the right to transfer or relinquish the ownership of the licensed Investment Entity, or dispose over it in whole or in part, for the benefit of a foreign or a Kuwaiti investor.

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<sup>523</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art. (27)(3) and Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) Art. (28).*

<sup>524</sup> Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art. (27).*

<sup>525</sup> *Id.*

<sup>526</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art. (11).*

<sup>527</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art. (12).*

<sup>528</sup> *Id.*

The Board shall establish the principles and regulations in this regard. In the event of transfer or relinquishment of ownership of the Investment Entity, in whole or in part, the new owner or assignee shall replace the original owner in rights and obligations.”<sup>529</sup>

In addition, the law provides foreign investors the right to repatriate the proceeds of their investments. These proceeds, which may include profits and capital, result from the transfer of the investor’s shares or from compensation for expropriation.<sup>530</sup> The law further grants the employees of foreign investment entities the right to repatriate any entitlements and savings.<sup>531</sup>

#### **5.1.2.7 Starting a Business**

In the most recent EDB report, Kuwait scored 88.4 out of 100 on the efficiency with which a business can be established in the country.<sup>532</sup> The new Kuwaiti FDI law obliges the investment authority to issue decisions on complete applications within 30 days of the date of submission. Article 15 of the law states that “[a] decision on the merits of the Application shall be rendered within thirty days from the date of submission of a complete Application with the data, documents and conditions set by the Authority.”<sup>533</sup>

The new FDI law additionally established a one-stop shop for licensing procedures within the investment authority.<sup>534</sup> Figure 5.2 illustrates Kuwait’s score for the ease of starting a business between 2008 and 2020.

#### **Figure 5.2** *Ease of starting a business in Kuwait*

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<sup>529</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (20).

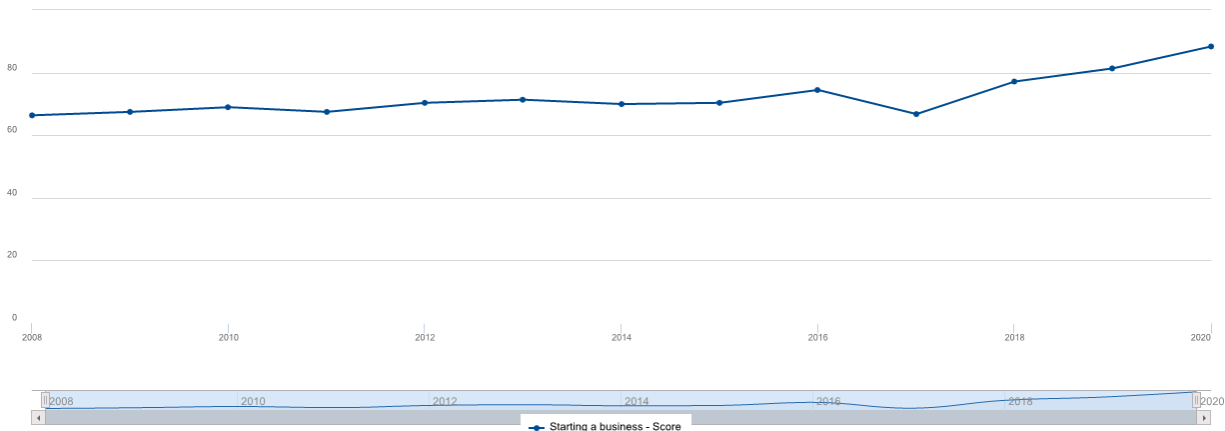
<sup>530</sup> *Id.* at *Art.* (22).

<sup>531</sup> *Id.*

<sup>532</sup> Starting a Business, Doing Business, <https://archive.doingbusiness.org/en/data/exploretopics/starting-a-business> (last visited July 15, 2022).

<sup>533</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (15).

<sup>534</sup> *Id.* at *Art.* (17).



Country : Kuwait  
 Source: Doing Business  
 Created on: 07/18/2022

### 5.1.2.8 Ownership of Real Estate

Foreigners are generally prohibited from owning real estate in Kuwait (with a few exceptions, including one for GCC and Arab nationals in designated residential areas, subject to several conditions).<sup>535</sup> In fact, the regulations explicitly prohibit companies with non-Kuwaiti partners from owning real estate.<sup>536</sup> An exception is made for joint-stock companies that have non-Kuwaiti partners.<sup>537</sup> The law allows such companies to own real estate for administrative purposes and to fulfill their objectives,<sup>538</sup> subject to approval from the authorities.

Thus, as a general rule, foreigners cannot own real estate in Kuwait. However, the foreign investment law may grant foreign investors the right to use real estate for investment purposes.

The old Kuwaiti FDI law stated that “[t]he Investment Committee *may* grant foreign investments

<sup>535</sup> Regulating the Ownership of Real Estate by Non-Kuwaitis, Law No. (74) of 1979 (Nov. 14, 1979) *Art. (1) and (3)*.

<sup>536</sup> *Id.* at *Art. (8)*.

<sup>537</sup> *Id.*

<sup>538</sup> *Id.*

all or part of the following privileges: ... Allotment of lands and real estates required for investment purpose in- accordance with the laws and regulations applicable in the State of Kuwait.”<sup>539</sup> The new law modified this regime slightly. It offers foreign investors incentives to use land or real estate instead of owning. Article 27 of the law states that “[t]he Investor *shall be* entitled to some or all of the following incentives ... The use of land and real estate allocated to the Authority or that is subject to its supervision or management, in accordance with the principles and rules established by the Board in this regard.”<sup>540</sup>

### 5.1.2.9 Free Trade Zones

In 1995, Kuwait passed Law No. 26,<sup>541</sup> which allowed the Kuwaiti Council of Ministers to establish free trade zones in Kuwait.<sup>542</sup> The law contains many incentives for businesses and foreign investors. These incentives include full foreign ownership of capital,<sup>543</sup> exemptions from corporate and income tax,<sup>544</sup> and exemptions from customs duties on the following: i) goods imported into or exported from the free trade zones<sup>545</sup> and ii) tools and equipment that are needed for the operation of an enterprise in a free trade zone.<sup>546</sup>

Kuwait did not establish its first free trade zone, Shuwaikh Port, until 1999. Shuwaikh Port is also the first free trade zone in the GCC region. Activity in the zone focuses on the storage of goods;<sup>547</sup> general trading activities, including import, export, assembly,<sup>548</sup> packing,<sup>549</sup>

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<sup>539</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001) *Art.* (13)(4).

<sup>540</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (27)(4).

<sup>541</sup> Kuwait Free Zones, Law No. (26) of 1995 (July 1, 1995).

<sup>542</sup> *Id.* at *Art.* (1).

<sup>543</sup> See PAUL D. KENNEDY, *DOING BUSINESS WITH KUWAIT* at 110 (2<sup>nd</sup> ed. 2004).

<sup>544</sup> Kuwait Free Zones, Law No. (26) of 1995 (July 1, 1995) *Art.* (5).

<sup>545</sup> *Id.*

<sup>546</sup> *Id.*

<sup>547</sup> Kuwait Free Zones, Law No. (26) of 1995 (July 1, 1995) *Art.* (2) and PAUL D. KENNEDY, *DOING BUSINESS WITH KUWAIT* at 110 (2<sup>nd</sup> ed. 2004).

<sup>548</sup> *Id.*

<sup>549</sup> *Id.*

and repacking;<sup>550</sup> and professional services that are necessary for activities inside the zone.<sup>551</sup>

Interestingly, the zone was not initially managed by the Kuwaiti government. Instead, its management was entrusted to the National Real Estate Company, which was private. Kuwaiti law permits free trade zones to be managed by private parties.<sup>552</sup> In 2007, the Kuwaiti Cabinet Council transferred the operation of this free trade zone from the private sector to the Kuwait Ports Authority, an organ of the state.<sup>553</sup>

### **5.1.3 Oman**

In Oman, FDI has been regulated by two codes. The first was the Foreign Capital Investment Law of 1994.<sup>554</sup> In 2019, Oman issued a new Foreign Capital Investment Law, which replaced the old one.<sup>555</sup> Oman also has laws and regulations that organize offshore foreign investments in free-trade and special economic zones.<sup>556</sup> The following paragraphs discuss the legal framework that governs FDI in Oman.

#### **5.1.3.1 Foreign Ownership of Capital**

Under the old Omani law, the general rule was that the share of foreign ownership could not exceed 49% of total capital.<sup>557</sup> This proportion could be increased to 65% by a decision of the Minister of Commerce and Industry, who would rely on the recommendations of the Foreign

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<sup>550</sup> *Id.*

<sup>551</sup> *Id.*

<sup>552</sup> Kuwait Free Zones, Law No. (26) of 1995 (July 1, 1995) *Art.* (11).

<sup>553</sup> Kuwait ministerial resolution No. (507) of 2006 (Nov. 27, 2006) *and* Kuwait ministerial resolution No. (536) of 2006 (Dec. 12<sup>th</sup>, 2006).

<sup>554</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994).

<sup>555</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019).

<sup>556</sup> Oman Free Zones Law, Sultani Decree No. (56) of 2002 (May 22, 2002) *and* Al Mazunah Free Zone Law, Sultani Decree No. (103) of 2005 (Dec. 21, 2005) *and* Salalah Free Zone Law, Sultani Decree No. (62) of 2006 (June 20<sup>th</sup>, 2006) *and* Sohar Free Zone Law, Sultani Decree No. (123) of 2010 (Dec. 21, 2010) *and* Duqm Special Economic Zone Law, Sultani Decree No. (119) of 2011 (Oct. 26, 2011).

<sup>557</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994) *Art.* (2)(a). However, in practice, the Ministry of Commerce, Industry and Investment Promotion in Oman permitted up to 70% foreign ownership in order to comply with Oman's commitments since joining the World Trade Organization in 2000.

Capital Investment Committee.<sup>558</sup> Moreover, the law permitted 100% foreign ownership for projects that contributed to the development of the national economy.<sup>559</sup> In such cases, the capital of the project could not be lower than OMR 500,000. In addition, full foreign ownership had to be approved by the Development Council, which would act on the recommendation of the Minister of Commerce and Industry.<sup>560</sup>

These restrictions and limitations on foreign ownership were removed upon the passage of the new Omani FDI Law. The new law allows 100% foreign ownership.<sup>561</sup> However, foreign enterprises cannot engage in activities on the negative list. The most recent list of 70 such activities was issued in 2020 and applies to all foreign entities except GCC- and US-owned companies,<sup>562</sup> which are treated equivalently to Omani nationals. The list includes the manufacture of traditional items, such as *halwa* (an Omani dessert),<sup>563</sup> the *kimmah* (an Omani cap),<sup>564</sup> the *abaya* (a gown),<sup>565</sup> and the *khanjar* (a traditional dagger).<sup>566</sup> The list also refers to insurance,<sup>567</sup> rehabilitation,<sup>568</sup> libraries and archives,<sup>569</sup> liquefied petrol and gas filling stations,<sup>570</sup>

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<sup>558</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994) *Art.* (2)(a).

<sup>559</sup> *Id.*

<sup>560</sup> *Id.*

<sup>561</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (6).

<sup>562</sup> Defining the List of Activities in Which Foreign Investment is Prohibited in Oman, Ministry of Commerce, Industry and Investment Promotion Resolution No. (209) of 2020 (Dec. 8, 2020).

<sup>563</sup> *Id.*

<sup>564</sup> *Id.*

<sup>565</sup> *Id.*

<sup>566</sup> *Id.*

<sup>567</sup> *Id.*

<sup>568</sup> *Id.*

<sup>569</sup> *Id.*

<sup>570</sup> *Id.*

diesel fuel stations,<sup>571</sup> real estate brokerages,<sup>572</sup> employment offices,<sup>573</sup> the general cleaning of buildings,<sup>574</sup> and photocopying and typing services.<sup>575</sup>

### 5.1.3.2 Form of the Legal Entity

The old FDI law, the new FDI law, and the Omani Commercial Companies Law do not contain restrictions on the form of foreign investment enterprises. Companies that have been established in Oman can be any of the following types: general partnership,<sup>576</sup> limited partnership,<sup>577</sup> joint venture,<sup>578</sup> joint-stock company (public or closed),<sup>579</sup> holding company,<sup>580</sup> limited liability company,<sup>581</sup> or one-person company.<sup>582</sup> Moreover, the current laws and regulations permit foreign companies to maintain branches and representative offices.<sup>583</sup>

### 5.1.3.3 National Treatment

Neither the old Omani FDI Law nor the Commercial Companies Law of 1974 explicitly granted national treatment to foreign investors.<sup>584</sup> However, the Commercial Companies Law of 2019 states that a company with foreign capital does not necessarily “enjoy the rights limited by law to the Omanis unless it is wholly owned by Omanis.”<sup>585</sup>

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<sup>571</sup> *Id.*

<sup>572</sup> *Id.*

<sup>573</sup> *Id.*

<sup>574</sup> *Id.*

<sup>575</sup> *Id.*

<sup>576</sup> Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13<sup>th</sup>, 2019) *Art.* (4).

<sup>577</sup> *Id.*

<sup>578</sup> *Id.*

<sup>579</sup> *Id.*

<sup>580</sup> *Id.*

<sup>581</sup> *Id.*

<sup>582</sup> *Id.*

<sup>583</sup> Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13<sup>th</sup>, 2019) *Art.* (13).

<sup>584</sup> *See* Oman Commercial Companies Law, Sultani Decree No. (4) of 1974 (May 15, 1974) *and* Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13<sup>th</sup>, 2019).

<sup>585</sup> Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13, 2019) *Art.* (13).

This state of affairs changed after the passage of the new FDI Law. The law explicitly grants national treatment to foreign investors. It states that “[a]n investment project shall enjoy all the benefits, incentives, and guarantees enjoyed by a national project in accordance with the laws in force in the Sultanate.”<sup>586</sup> Furthermore, Oman is the only GCC country that grants preferential treatment to foreign investors by force of law. The law stipulates that “[i]t is permitted, by a decision of the Council of Ministers on the basis of a recommendation by the minister, to declare a preferential treatment for a foreign investor in application of the principle of reciprocity.”<sup>587</sup>

#### 5.1.3.4 Tax

Under the old FDI law, foreign investors could be exempted from income tax for up to five years, and the exemption could be renewed once.<sup>588</sup> Such tax exemptions were not automatic, but instead subject to the discretion of the Vice President of the Financial Affairs and Energy Resources Council, who acted on requests from the Minister of Commerce and Industry.<sup>589</sup> However, the new FDI Law does not grant special tax exemptions to foreign investors. It refers to the Income Tax Law. The relevant provision stipulates that “[t]ax exemption for the investment project shall be in accordance with the provisions of the Income Tax Law.”<sup>590</sup>

The current Income Tax Law does not grant special tax exemptions to foreigners; it treats foreign investors in the same way as national investors. Under the tax law, proprietorships,<sup>591</sup>

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<sup>586</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (18).

<sup>587</sup> *Id.*

<sup>588</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994) *Art.* (8).

<sup>589</sup> *Id.*

<sup>590</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (22).

<sup>591</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (112).

Omani companies,<sup>592</sup> and permanent establishments<sup>593</sup> (including foreign branches and representative offices)<sup>594</sup> are subject to a 15% corporate tax.<sup>595</sup> The tax rate increases to 55% if an entity engages in petroleum exploration.<sup>596</sup> The rate of corporate tax is reduced to 3% if the entity satisfies the following conditions:<sup>597</sup>

- 1) its activity does not concern transport by air or sea,<sup>598</sup> banking, insurance, finance,<sup>599</sup> the extraction of natural resources,<sup>600</sup> public utilities concessions,<sup>601</sup> or any other activity that the Council of Ministers decides to exclude;<sup>602</sup>
- 2) its capital does not exceed OMR 50,000;<sup>603</sup>
- 3) its annual income does not exceed OMR 100,000;<sup>604</sup> and
- 4) the average number of employees at the entity does not exceed 15.<sup>605</sup>

In addition, the tax law exempts maritime transportation enterprises from corporate tax<sup>606</sup> if they are owned by an Omani natural person<sup>607</sup> or an Omani company (which could have foreign capital but must be incorporated in Oman and have its headquarters in the country).<sup>608</sup> The law also exempts entities that are not owned by Omanis or Omani companies and that

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<sup>592</sup> *Id.*

<sup>593</sup> *Id.*

<sup>594</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (2).

<sup>595</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (112).

<sup>596</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (114).

<sup>597</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (159).

<sup>598</sup> *Id.*

<sup>599</sup> *Id.*

<sup>600</sup> *Id.*

<sup>601</sup> *Id.*

<sup>602</sup> *Id.*

<sup>603</sup> *Id.*

<sup>604</sup> *Id.*

<sup>605</sup> *Id.*

<sup>606</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (116).

<sup>607</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (116)(1).

<sup>608</sup> Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13, 2019) *Art.* (12).

engage in maritime transport from corporate tax,<sup>609</sup> subject to a condition of reciprocal treatment in the country of the foreign company.<sup>610</sup>

#### **5.1.3.5 Tariff and Customs Duty Exemptions**

Under the old FDI law, foreign investors could benefit from exemptions on customs duties on some imports. These imports included i) machinery for foreign projects<sup>611</sup> and ii) raw materials that were unavailable locally.<sup>612</sup> However, the Omani legislature restricted these exemptions to a period that could not exceed five years, and the exemption could be renewed once.<sup>613</sup> Neither the exemption nor its renewal were automatic. Instead, they were at the discretion of the Vice President of the Financial Affairs and Energy Resources Council, who would act on the recommendation of the Minister of Commerce and Industry.<sup>614</sup>

The new Omani FDI Law refers to its implementing regulations to identify investment projects that may be exempted from customs duties and specifies the duration of these exemptions.<sup>615</sup> However, the Omani FDI implementing regulation has not yet been issued. Therefore, it is difficult to compare customs duties under the old law to those under the new one.

#### **5.1.3.6 Transferability of Capital and Earnings**

The old FDI law permitted the transfer of foreign capital and of the profits of the enterprise. Article 5 of the law stated that “[t]he investors in the investment projects shall be free to conduct the licensed economic activity and to transfer abroad the imported capital along with the profits accrued from the project.”<sup>616</sup>

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<sup>609</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (116)(2).

<sup>610</sup> *Id.*

<sup>611</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994) *Art.* (8).

<sup>612</sup> *Id.*

<sup>613</sup> *Id.*

<sup>614</sup> *Id.*

<sup>615</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (20).

<sup>616</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994) *Art.* (11).

The new Omani FDI Law explicitly permits foreign investors to transfer their shares without restrictions, in whole or in part, to both Omanis and non-Omanis. The law states that “[i]t is permitted for the foreign investor—in accordance with the laws in force in the Sultanate— to transfer the ownership of the investment project in whole or in part to another foreign or Omani investor, or transfer it to his partner in case of a partnership, a merger, an acquisition, or transformation of its legal form, and in these cases the treatment of the investment project shall continue in accordance with the provisions of this law, provided that the new investor continues to work on the investment project, and takes the place of the former investor in regard to rights and obligations.”<sup>617</sup>

The new law also allows foreign investors to transfer the proceeds of investment projects out of the Sultanate without restrictions. These proceeds include returns on investments,<sup>618</sup> gains from the sale or the liquidation of all or part of the investment,<sup>619</sup> investment dispute settlements,<sup>620</sup> compensation for expropriation,<sup>621</sup> premia from foreign loans or other financial arrangements,<sup>622</sup> transfers related to importation or exportation operations conducted in connection with the activity of the investment project,<sup>623</sup> and fees for the rental of machines or services rendered within the framework of a project.<sup>624</sup>

### **5.1.3.7 Starting a Business**

In 2020, the Omani Ministry of Commerce and Industry established a one-stop shop for investment permits. This initiative helped to reduce the bureaucratic burden of starting a

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<sup>617</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (27).

<sup>618</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (26).

<sup>619</sup> *Id.*

<sup>620</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (26).

<sup>621</sup> *Id.*

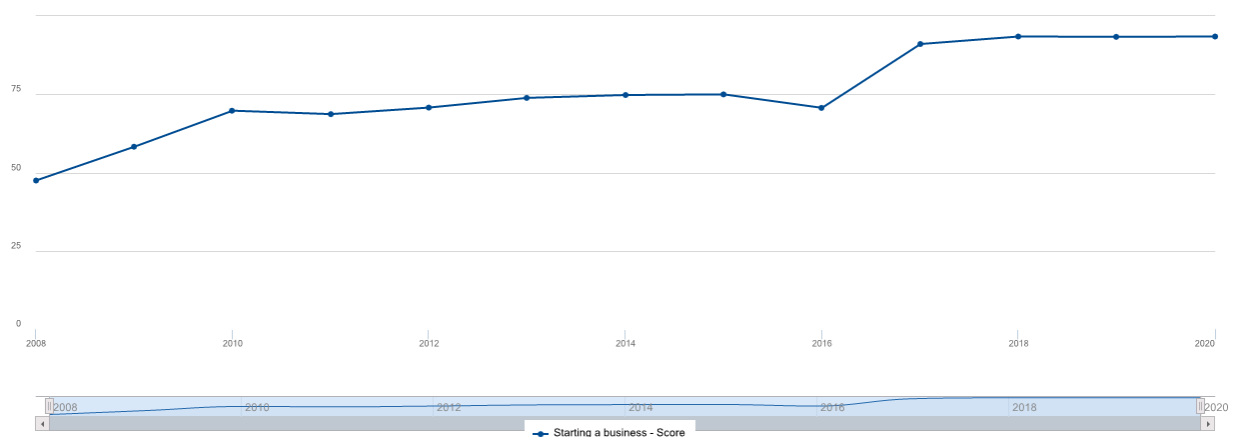
<sup>622</sup> *Id.*

<sup>623</sup> *Id.*

<sup>624</sup> *Id.*

business. In the most recent EDB report, Oman received a score of 93.5 out of 100 for the ease of starting a business.<sup>625</sup> That score is based on considerations of time and expense. Figure 5.3 below illustrates Oman’s score for the ease of starting a business between 2008 and 2020.

**Figure 5.3** *Ease of starting a business in Oman*



Country : Oman  
Source: Doing Business  
Created on: 07/18/2022

### 5.1.3.8 Ownership of Real Estate

The old Omani FDI law did not permit foreign investors to own real estate. However, they could lease or usufruct land (temporary arrangements whereby a user enjoys the fruit of property owned by others)<sup>626</sup> that was needed for an investment project. The law stated that “[t]he land needed for investment projects *may* be allocated by usufruct or through rent for a long period.”<sup>627</sup>

<sup>625</sup> Starting a Business, Doing Business, <https://archive.doingbusiness.org/en/data/exploretopics/starting-a-business> (last visited July 15, 2022).

<sup>626</sup> GEORGE A. BERMAN & ETIENNE PICARD, INTRODUCTION TO FRENCH LAW at 161-162 (2008).

<sup>627</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994) *Art.* (10).

The new Omani FDI Law is silent on the foreign ownership of real estate, but in 2018, the Omani legislature passed a law that prohibited non-Omanis from owning real estate in certain areas of the country.<sup>628</sup> Nevertheless, the new FDI law identifies certain areas in which investment projects can obtain long leases or usufruct rights.<sup>629</sup>

### 5.1.3.9 Free Zones

In 2002, Oman issued the Free Zones Law.<sup>630</sup> At the time of writing, there are three free zones and two special economic zones in Oman. The three free zones are the Al Mazunah Free Zone,<sup>631</sup> the Salalah Free Zone,<sup>632</sup> and the Sohar Free Zone.<sup>633</sup> The special economic zones are the Duqm Special Economic Zone and Knowledge Oasis Muscat.<sup>634</sup> Each zone specializes in particular activities, and each is regulated by separate laws and regulations. These regulations are not restrictive by nature, because their purpose is to promote and encourage foreign investment. The incentives for foreign investment under the regulations include full foreign ownership of capital,<sup>635</sup> corporate tax holidays,<sup>636</sup> customs exemptions for imports and exports,<sup>637</sup> and exemptions from the Commercial Agency Law, such as allowing foreigners to start businesses without recruiting local agents.<sup>638</sup>

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<sup>628</sup> Organizational Regulation of Real Estate Investment Funds in Oman, Ministry of Housing, Ministerial Decision No. (95) of 2017 (Nov. 15, 2017).

<sup>629</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (19).

<sup>630</sup> Oman Free Zones Law, Sultani Decree No. (56) of 2002 (May 22, 2002).

<sup>631</sup> Al Mazunah Free Zone Law, Sultani Decree No. (103) of 2005 (Dec. 21, 2005).

<sup>632</sup> Salalah Free Zone Law, Sultani Decree No. (62) of 2006 (June 20, 2006).

<sup>633</sup> Sohar Free Zone Law, Sultani Decree No. (123) of 2010 (Dec. 21, 2010).

<sup>634</sup> Duqm Special Economic Zone Law, Sultani Decree No. (119) of 2011 (Oct. 26, 2011).

<sup>635</sup> Oman Free Zones Law, Sultani Decree No. (56) of 2002 (May 22, 2002) *Art.* (4).

<sup>636</sup> Oman Free Zones Law, Sultani Decree No. (56) of 2002 (May 22, 2002) *Art.* (3).

<sup>637</sup> Oman Free Zones Law, Sultani Decree No. (56) of 2002 (May 22, 2002) *Art.* (17).

<sup>638</sup> Oman Free Zones Law, Sultani Decree No. (56) of 2002 (May 22, 2002) *Art.* (13).

## 5.1.4

### *Qatar*

Qatar has passed two laws that regulate FDI. The first law was the Organization of Foreign Capital Investment in Economic Activity Law of 2000,<sup>639</sup> which was amended in 2005. In 2019, the Non-Qatari Capital Investment in Economic Activity Law<sup>640</sup> replaced the 2000 law.

The paragraphs that follow discuss the legal framework for FDI in Qatar by reference to the old and the new Qatari foreign capital investment laws and the special regulations on free zones.

#### **5.1.4.1 Foreign Ownership of Capital**

Under the previous Qatari Foreign Capital Investment Law, the general rule, with certain exceptions, was that foreign investors could own no more than 49% of the capital of a company.<sup>641</sup> In the sectors that were exempt from this rule, full foreign ownership was permitted upon the approval of the Minister of Finance, Economy, and Commerce. These sectors were agriculture, industry, healthcare, education, tourism, the exploitation and development of natural resources, energy, and mining.<sup>642</sup>

Apart from the limitation on foreign ownership share, the law also completely prohibited foreign investment in certain sectors and activities. These sectors and activities were banking

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<sup>639</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000).

<sup>640</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019).

<sup>641</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (2)(1)*.

<sup>642</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (2)(2)*.

(unless approved by the Council of Ministers),<sup>643</sup> insurance (unless approved by the Council of Ministers),<sup>644</sup> commercial agency,<sup>645</sup> and the purchase of real estate.<sup>646</sup>

After the passage of the new Non-Qatari Capital Investment Law, the limitations on capital ownership changed, allowing foreign investors to own 100% of any Qatari enterprise. Article 2 of the new law states, “Without prejudice to legislation regulating non-Qataris’ practices of commercial businesses and professions, and the provisions of Article (4) hereof, a Non-Qatari Investor may invest in all economic sectors even with a capital up to 100% in accordance with the Executive Regulations of this Law.”<sup>647</sup> However, Article 4 also provides for certain exceptions. It prohibits foreign investments in banks and insurance companies (unless approved by the Council of Ministers)<sup>648</sup> and in commercial agencies.<sup>649</sup> Furthermore, it states that if the Council of Ministers decides to add an activity to the negative list,<sup>650</sup> the legislature may expand it.

#### **5.1.4.2 Form of the Legal Entity**

Qatari law does not obligate non-Qatari investors to adopt particular forms of organization. As such, non-Qatari investors may adopt any of the forms that are mentioned in the Qatari Commercial Companies Law. The permitted forms are a joint liability company, limited partnership, joint venture company, public shareholding company, private shareholding company, partnership limited by shares, and limited liability company.<sup>651</sup> It should be noted that

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<sup>643</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (2)(3)*.

<sup>644</sup> *Id.*

<sup>645</sup> *Id.*

<sup>646</sup> *Id.*

<sup>647</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art. (2)*.

<sup>648</sup> *Id.* at *Art. (4)*.

<sup>649</sup> *Id.*

<sup>650</sup> *Id.*

<sup>651</sup> Qatar Commercial Companies Law, Law No. (11) of 2015 (July 7, 2015) *Art. (4)*.

the old Foreign Capital Investment Law restricted non-Qatari investors to 25% stakes in public joint-stock companies.<sup>652</sup> This proportion was later increased to 49%, a rule that has been retained in the new Non-Qatari Capital Investment Law.<sup>653</sup> In addition, the Qatari Companies Law prohibits joint venture companies that have non-Qatari partners from engaging in business activities on the negative list that was described in the preceding paragraph. However, foreign investors in Qatar can establish branches and representative offices.

#### **5.1.4.3 National Treatment**

The Qatari Foreign Capital Investment Law does not explicitly address national treatment. Nevertheless, it states, “Every company incorporated in the State of Qatar shall be a Qatari company, and the headquarters thereof shall be based in Qatar. However, this provision shall not dictate that the company enjoys the rights that are legally confined to Qataris unless it is fully owned by Qatari nationals.”<sup>654</sup> Thus, although companies that are owned by non-Qataris are considered Qatari national companies, the law does not necessarily grant them the same rights as companies that are exclusively owned by Qataris.

#### **5.1.4.4 Tax**

The old Qatari Foreign Capital Investment Law did not automatically exempt foreign investors from income tax.<sup>655</sup> Instead, the Ministry of Finance, Economy, and Commerce had discretion to grant such exemptions.<sup>656</sup> The law authorized the Ministry to exercise its discretion

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<sup>652</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (2)(4)*.

<sup>653</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art. (7)*.

<sup>654</sup> Qatar Commercial Companies Law, Law No. (11) of 2015 (July 7, 2015) *Art. (3)*.

<sup>655</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (7)(1)*.

<sup>656</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (7)*.

to exempt foreign investors from income tax for a period that could not exceed 10 years from the start of a project.<sup>657</sup>

Article 10 of the new Non-Qatari Capital Investment Law states, “Non-Qatari Investment projects may be exempted from income tax in accordance with controls, procedures and periods provided in the aforementioned Law of Income Tax.”<sup>658</sup> In other words, the Qatari law does not explicitly exempt foreign investors from income tax. Such exemptions are at the discretion of the legislature. There is no maximum period for exemption, which is a departure from the old law.

#### **5.1.4.5 Tariff- and Customs Duty-Related Exemptions**

The old Qatari Foreign Capital Investment Law did not automatically exempt foreign investors from customs duties. It authorized the Ministry of Finance, Economy, and Commerce to grant such exemptions for two classes of imported items,<sup>659</sup> namely (1) equipment, machinery, and raw materials<sup>660</sup> and (2) semi-manufactured materials that are unavailable on the Qatari market.<sup>661</sup>

The new Non-Qatari Capital Investment Law also exempts these goods from customs duties. However, unlike in the old law, the grant of exemptions is not subject to the discretion of the Ministry of Finance, Economy, and Commerce. Instead, all foreign investors automatically benefit from the exemptions. Article 11 reads as follows: “Non-Qatari investment projects shall be exempted from custom taxes in respect to imported machinery and equipment needed for

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<sup>657</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (7)(1)*.

<sup>658</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art. (10)*.

<sup>659</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (7)*.

<sup>660</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (7)(2)*.

<sup>661</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art. (7)(3)*.

setting up the projects. Non-Qatari investment industrial projects shall be exempted from customs on imported raw and half-manufactured materials which are needed for production and which are not available in domestic markets.”<sup>662</sup>

#### 5.1.4.6 Transferability of Capital and Earnings

Under the old Qatari Foreign Capital Investment Law, foreign investors could transfer the ownership of their investment to other foreign or domestic investors.<sup>663</sup> The law also allowed foreign investors to transfer the returns on their investments outside of the country.<sup>664</sup> These provisions covered investment revenues,<sup>665</sup> the proceeds from the partial or complete sale or liquidation of an investment,<sup>666</sup> money received in settlement of an investment dispute,<sup>667</sup> and compensation for expropriation.<sup>668</sup>

The new Non-Qatari Capital Investment Law similarly permits foreign investors to transfer the ownership of their investments to others, including both Qatari and non-Qatari investors.<sup>669</sup> Foreign investors are also allowed to transfer all of their earnings from the investment outside of Qatar, and a no-delay privilege is available.<sup>670</sup> Examples of such transfers

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<sup>662</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (11).

<sup>663</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (10).

<sup>664</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (9)(1).

<sup>665</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (9)(1)(A).

<sup>666</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (9)(1)(B).

<sup>667</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (9)(1)(C).

<sup>668</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (9)(1)(D); *see also Art.* (8).

<sup>669</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (15).

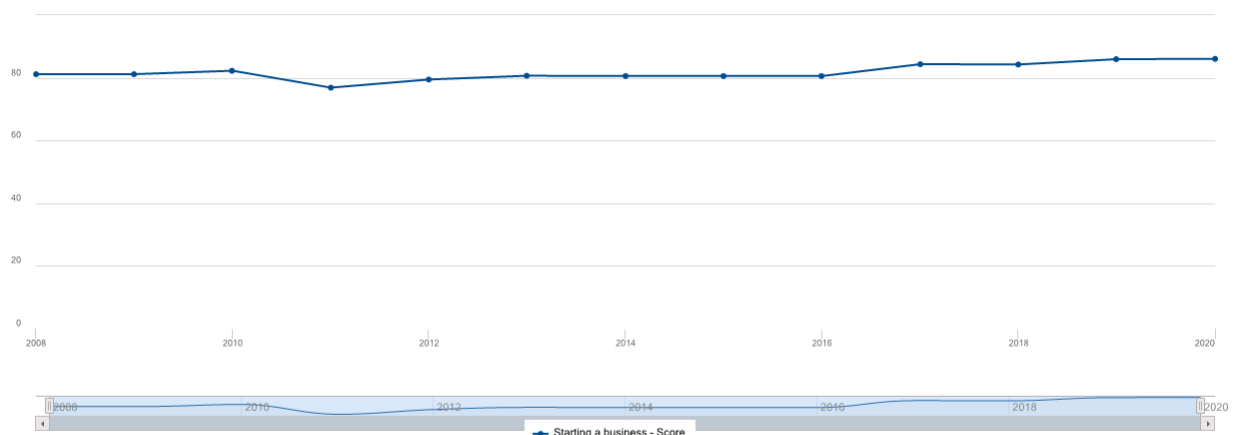
<sup>670</sup> *Id.* at *Art.* (14)(1).

include investment revenues,<sup>671</sup> proceeds from the full or partial sale or liquidation of an investment,<sup>672</sup> money received in settlement of an investment dispute,<sup>673</sup> and compensation.<sup>674</sup>

#### 5.1.4.7 Starting a Business

In 2016, the Qatari Ministry of Finance, Economy, and Commerce established a one-stop shop for licenses and registrations at the Ministry of Business and Trade. According to the last EDB report, Qatar earned a score of 86.1 out of 100 for the ease with which one can start a business in the country.<sup>675</sup> That score is based on considerations of time and cost. Figure 5.4 below illustrates Qatar's score for the ease of starting a business between 2008 and 2020.

**Figure 5.4** *Ease of starting a business in Qatar*



Country : Qatar  
Source: Doing Business  
Created on: 07/18/2022

<sup>671</sup> *Id.*

<sup>672</sup> *Id.*

<sup>673</sup> *Id.*

<sup>674</sup> *Id.*

<sup>675</sup> Starting a Business, Doing Business, <https://archive.doingbusiness.org/en/data/exploretopics/starting-a-business> (last visited July 15, 2022).

#### 5.1.4.8 Ownership of Real Estate

In general, only Qataris and GCC nationals can own real estate in Qatar. Non-GCC nationals, whether individuals or corporations, are prohibited from purchasing real estate. However, in 2004, Qatar allowed foreigners to own real estate in certain areas.<sup>676</sup> These areas are the Pearl, the West Bay Lagoon, and parts of Al Khor.<sup>677</sup> The law was then amended in 2020 to include more areas.<sup>678</sup>

Furthermore, the law permits foreign investors to enter into long-term rental arrangements for investment purposes. Under Article 5 of the old law, the term of such leases was capped at 50 years. The article in question stated, “Non-Qatari investors may be allocated the land necessary to set up their investments thereon, by a way of a renewable rent for a long period of not more than 50 years.”<sup>679</sup> However, this cap on the lease period was removed in the new law. Article 8 states, “The needed lands may be allocated to the Non-Qatari Investor to establish their investment project by means of either leasing or usufruct in accordance with the applicable laws in this respect.”<sup>680</sup>

#### 5.1.4.9 Free Zones

Qatar’s free zones are not subject to its commercial and civil laws. They are regulated separately, except in criminal matters.<sup>681</sup> At present, there are four free zones in Qatar: the Umm Al Houl Free Zone, the Ras Bu Fontas Free Zone, the Qatar Financial Centre, and the

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<sup>676</sup> The Organization of Ownership and Use of Real Estate and Residential Units by Non-Qataris, Cabinet Decision No. (20) of 2004 (June 30, 2004).

<sup>677</sup> The Organization of Ownership and Use of Real Estate and Residential Units by Non-Qataris, Cabinet Decision No. (20) of 2004 (June 30, 2004) *Art.* (1).

<sup>678</sup> Specifying the Areas in which Non-Qataris May Own and Use the Real Estate, and the Conditions, Controls, Benefits and Procedures for their Ownership and Use thereof, Cabinet Decision No. (28) of 2020 (Aug. 30, 2020).

<sup>679</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000) *Art.* (5).

<sup>680</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (8).

<sup>681</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) *Art.* (39).

Qatar Science and Technology Park. Umm Al Houl and Ras Bu Fontas are governed by the Investment Free Zones Law.<sup>682</sup> Activity in the two zones is limited to industry and manufacturing. Separate laws and regulations govern the Qatar Financial Centre and the Qatar Science and Technology Park.<sup>683</sup>

Each of the free zone areas is free to offer incentives to investors, which may include 100% foreign ownership,<sup>684</sup> a 20-year corporate tax holiday, which may be extended for one or more period,<sup>685</sup> zero customs duties on imports,<sup>686</sup> and full repatriation of profits and capital.<sup>687</sup> Notably, products that are exported from the free zones to other parts of the country are subject to customs duties.<sup>688</sup>

### **5.1.5** *Saudi Arabia*

The Foreign Capital Investment Law of 1399 AH (1979 CE) was the first law to regulate FDI in Saudi Arabia.<sup>689</sup> It was later repealed by the Foreign Investment Law of 1421 AH (2000 CE).<sup>690</sup> In 2019, the Saudi legislature again introduced a new Foreign Investment Bill. However, it has not been passed into law. The Foreign Capital Investment Law of 1979 is outdated and beyond the scope of this study. The 2019 law is yet to be approved and implemented. Therefore,

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<sup>682</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005).

<sup>683</sup> Qatar Financial Centre Law, Law No. (7) of 2005 (Mar. 3, 2005) *and* Amending Certain Provisions of the Qatar Financial Centre (QFC) Law as Promulgated by Law No. (7) of 2005, Law No. (2) of 2009 (Feb. 2, 2009) *and* Establishing a Free Zone for Qatar Science and Technology Park, Law No. (36) of 2005 (Sept. 26, 2005).

<sup>684</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) *Art.* (5).

<sup>685</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) *Art.* (7).

<sup>686</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) *Art.* (8).

<sup>687</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) *Art.* (10).

<sup>688</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) *Art.* (9).

<sup>689</sup> Saudi Arabia Foreign Capital Investment Law, Royal Decree No. M/4, 2 *Safar* 1399 A.H. (Jan. 1, 1979).

<sup>690</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000).

the following paragraphs discuss the legal framework for FDI in Saudi Arabia by reference to the law of 2000 (the Saudi FDI Law) and its implementing regulations.<sup>691</sup>

#### 5.1.5.1 Foreign Ownership of Capital

According to the current Saudi FDI Law, there are two ways in which a foreign investor can acquire capital in entities that operate in Saudi Arabia. Such investors can either enter into a partnership with a Saudi national<sup>692</sup> or become sole owners of a business.<sup>693</sup> In the second case, the company cannot engage in activities on the negative list. The Saudi legislature periodically simplifies the negative list. Article 3 of the Implementing Regulations of the Saudi FDI Law states, “The Board of Directors shall periodically review the list of activities excluded from foreign investment in order to shorten it and submit it to the Council to consider its approval.”<sup>694</sup> The list currently includes 10 sectors, services, and activities, which are as follows:<sup>695</sup>

- 1) oil exploration, drilling, and production, except some mining services;
- 2) catering in the military sector;
- 3) security and detective services;
- 4) real estate investment in the holy cities of Mecca and Medina;
- 5) tourist orientation and guidance services for religious tourism related to *hajj* and *umrah*;
- 6) printing and publishing (subject to a variety of exceptions);
- 7) certain internationally classified commission agents;

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<sup>691</sup> Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014).

<sup>692</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (5)(1).

<sup>693</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (5)(2).

<sup>694</sup> Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (3).

<sup>695</sup> Services Manual Eighth Edition, January 2020, Ministry of Investment, MISA.GOV.SA, <https://www.misa.gov.sa/media/1128/moi-service-manual-8th-edition-en-v4.pdf> (last visited June 07, 2021).

- 8) the services provided by midwives and nurses, physical therapy services, and quasi-doctoral services;
- 9) fisheries; and
- 10) the operation of poison centers, blood banks, and quarantine services.

### 5.1.5.2 Form of the Legal Entity

The permissible forms of foreign enterprise in Saudi Arabia depend on the level of foreign ownership. If an enterprise is co-owned with Saudi investor(s), it can take any of the five forms that are permissible under the Companies Law, namely general partnership,<sup>696</sup> simple limited partnership,<sup>697</sup> joint venture,<sup>698</sup> joint-stock company,<sup>699</sup> or limited liability company.<sup>700</sup> However, if the capital of the enterprise is wholly owned by the foreign investor(s), then it can only take the form of a limited liability company,<sup>701</sup> joint-stock company,<sup>702</sup> branch of a foreign company,<sup>703</sup> representative office in Saudi Arabia,<sup>704</sup> or any other legal form that the Ministry of Investment approves.<sup>705</sup>

### 5.1.5.3 National Treatment

The Saudi legislature extends the treatment that it affords to domestic citizens and companies to licensed foreign investors. Article 6 of the Saudi FDI Law of 2000 states, “The

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<sup>696</sup> Saudi Arabia Companies Law, Royal Decree No. M/3, 28 *Muharam* 1437 A.H. (Nov. 11, 2015) *Art.* (3)(1).

<sup>697</sup> *Id.*

<sup>698</sup> *Id.*

<sup>699</sup> *Id.*

<sup>700</sup> *Id.*

<sup>701</sup> Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (4)(2).

<sup>702</sup> *Id.*

<sup>703</sup> *Id.*

<sup>704</sup> *Id.*

<sup>705</sup> *Id.* It is worth noting that the wording of the law allocates this function to the Board of Directors of the Saudi Arabian General Investment Authority (SAGIA) instead of the Ministry of Investment. However, in February 2020, the SAGIA was transformed into the Ministry of Investment. *See* Royal Decree No. A/453, 1 *Rajab* 1441 A.H. (Feb. 25, 2020).

enterprise licensed under this Law shall enjoy all the benefits, incentives and guarantees extended to a national enterprise according to laws and directives.”<sup>706</sup> Therefore, foreign enterprises in Saudi Arabia enjoy the same benefits and incentives as Saudi-owned companies unless a law stipulates otherwise. Tax laws are one such exception, as explained in the paragraph that follows.

#### 5.1.5.4 Tax

One of the areas in which the Saudi legislature differentiates between foreign and national investors is corporate taxation. Unlike the old Saudi FDI Law of 1979, which granted foreign investors tax holidays of up to 10 years,<sup>707</sup> the Saudi FDI Law of 2000 does not provide for such privileges. Moreover, the current regulations impose differential tax rates on foreign and Saudi investors by dividing them into three categories: companies that are wholly owned by Saudis (or GCC nationals, who also benefit from national treatment), companies that are wholly owned by foreign investors, and companies that are co-owned by Saudi and non-Saudi partner(s). First, Saudi-owned companies are subject to an Islamic rate called *zakat*, which is 2.5% of the net profits of the company.<sup>708</sup> Therefore, if the company is wholly owned by a Saudi or a GCC national, it is liable to pay 2.5% of its net profits in tax.<sup>709</sup>

Second, if a company is wholly owned by a foreign investor(s), it is subject to the Saudi Income Tax Law.<sup>710</sup> Under Article 2 of that law, the following persons are subject to income tax:

- (a) resident capital companies, with respect to the shares of the non-Saudi partners;
- (b) resident non-Saudi natural persons who conduct business in the Kingdom;
- (c) non-residents who conduct business in the Kingdom through a permanent establishment;

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<sup>706</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (6).

<sup>707</sup> Saudi Arabia Foreign Capital Investment Law, Royal Decree No. M/4, 2 *Safar* 1399 A.H. (Jan. 1, 1979) *Art.* (7).

<sup>708</sup> Implementing Regulation of the Saudi Arabia Zakat Collection, Ministerial Resolution No. (2216), 7 *Rajab* 1440 A.H. (Mar. 14, 2019) *Art.* (2).

<sup>709</sup> *Id.* at *Art.* (14).

<sup>710</sup> Saudi Arabia Income Tax Law, Royal Decree No. M/1, 15 *Muharram* 1425 A.H. (Mar. 7, 2004).

- (d) non-residents with other taxable income from sources within the Kingdom;
- (e) persons engaging in natural gas investment; and
- (f) persons engaging in oil and hydrocarbon production.<sup>711</sup>

The tax rates for these persons are as follows:

- (a) The tax rate of the tax base is 20% for each of the following:
  - (1) a resident capital company.
  - (2) a non-Saudi resident natural person who conducts business in the Kingdom; and
  - (3) a non-resident person who conducts business in the Kingdom through a permanent establishment.<sup>712</sup>

Therefore, if an enterprise is wholly owned by a foreign investor or by multiple foreign investors, it is subject to income tax in the amount of 20% of its net profits.

Third, in the case of an investment that is co-owned by Saudi and non-Saudi partners, the Saudi partners are subject to the *zakat* rate of 2.5% of net adjusted profits, in line with the Zakat Collection Law.<sup>713</sup> The foreign partner(s) are subject to the tax rate from the Income Tax Law,<sup>714</sup> which, as previously mentioned, is 20% of net adjusted profits.

It is worth noting that the tax rate for certain business activities in Saudi Arabia is different for both Saudi- and non-Saudi-owned investments. The tax rate for investments in natural gas activities, for instance, is 30%.<sup>715</sup> For the production of oil and hydrocarbon materials, it is 85%.<sup>716</sup>

#### **5.1.5.5 Tariff and Customs Duty Exemption**

Foreign investors in Saudi Arabia are subject to the same customs duties and exemptions as Saudi investors. In Saudi Arabia, customs duties range between 5% and 12%, depending on

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<sup>711</sup> *Id.* at Art. (2).

<sup>712</sup> *Id.*

<sup>713</sup> Implementing Regulation of the Saudi Arabia Zakat Collection, Ministerial Resolution No. (2216), 7 *Rajab* 1440 A.H. (Mar. 14, 2019) Art. (14).

<sup>714</sup> Saudi Arabia Income Tax Law, Royal Decree No. M/1, 15 *Muharram* 1425 A.H. (Mar. 7, 2004) Art. (2).

<sup>715</sup> *Id.*

<sup>716</sup> *Id.*

the good that is being imported. In 2020, the Saudi government raised some of these rates to 15% for certain items.<sup>717</sup> However, Saudi Arabia has an industrial exemption program, through which goods that are imported for the purposes of industrial production are exempt from duties.<sup>718</sup> Those items include machinery, equipment, raw materials, semi-manufactured materials, and packing materials.<sup>719</sup> In addition, as in other GCC countries, certain approved imports are exempt from customs duties on the basis of the GCC Common Customs Law.<sup>720</sup>

#### 5.1.5.6 Transferability of Capital and Repatriation of Earnings

The current Saudi regulations do not restrict the transferability of foreign shares; the same rules apply to Saudi and non-Saudi shareholders. Furthermore, the current law allows foreign investors to repatriate the proceeds of their investments without restrictions.<sup>721</sup> Those proceeds include income from the sale of shares held by foreigners,<sup>722</sup> proceeds from the liquidation of an enterprise,<sup>723</sup> profit,<sup>724</sup> and amounts received in the settlement of a dispute.<sup>725</sup>

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<sup>717</sup> See The List of Goods Categories and Applied Customs Duties to be Raised to the Current Limit as Established by the World Trade Organization, First Edition, June 2020, Zakat, Tax and Customs Authority, CUSTOMS.GOV.SA, <https://www.customs.gov.sa/sites/default/files/2020-06/البنود%20المستهدف%20رفع%20رسومها%20مع%20التصنيف/06/التصنيف%20مع%20البنود%20المستهدف%20رفع%20رسومها%20مع%20التصنيف.pdf> (last visited June 07, 2021).

<sup>718</sup> See Amended Controls for Exemption of Industry Inputs from Customs Taxes “Duties” in GCC Member States (2009).

<sup>719</sup> Amended Controls for Exemption of Industry Inputs from Customs Taxes “Duties” in GCC Member States (2009) *Art.* (2).

<sup>720</sup> Common Customs Law of the GCC States, Rules of Implementation and Explanatory Notes (2003).

<sup>721</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (7) and Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (5)(5).

<sup>722</sup> *Id.*

<sup>723</sup> *Id.*

<sup>724</sup> *Id.*

<sup>725</sup> *Id.*

### 5.1.5.7 Starting a Business

In order to reduce the complexities and delays that inhere in government bureaucracy,<sup>726</sup> the Saudi government established the Saudi Arabian General Investment Authority (SAGIA) in 2000.<sup>727</sup> This entity granted licenses to foreign investors and was designed as a one-stop-shop facility for licenses,<sup>728</sup> including those that must be obtained to employ workers.<sup>729</sup> In 2020, the SAGIA became the Ministry of Investment.<sup>730</sup> The ministry oversees investments in Saudi Arabia and handles all of the former responsibilities of the SAGIA.

According to the most recent EDB report, Saudi Arabia scored 93 out of 100 for the ease with which one can start a business in the country.<sup>731</sup> This score reflects considerations of time and expense. Figure 5.5 below illustrates Saudi Arabia's score for the ease of starting a business between 2008 and 2020.

**Figure 5.5** *Ease of starting a business in Saudi Arabia*

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<sup>726</sup> See Saudi Arabian General Investment Authority (SAIGA) Statute, Royal Decree, No. (20), dated 5 *Muharram* 1421 (Apr. 10, 2000) and Regulations of Saudi Arabian General Investment Authority, Ministerial Decision No. (2), 5 *Muharram* 1421 A.H. (Apr. 10, 2000). See also Bassam A. Albassam, *Does Saudi Arabia's Economy Benefit from Foreign Investments?*, 22 *BENCHMARKING: AN INTERNATIONAL JOURNAL* 1214, 1214–1228 (2015).

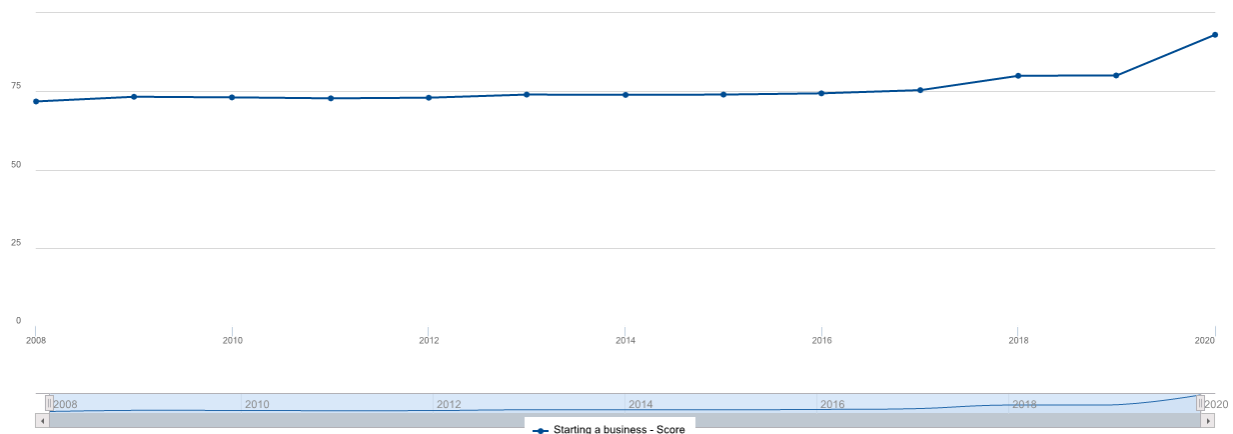
<sup>727</sup> See Saudi Arabian General Investment Authority (SAIGA) Statute, Royal Decree No. (20), dated 5 *Muharram* 1421 (Apr. 10, 2000) and Regulations of Saudi Arabian General Investment Authority, Ministerial Decision No. (2), 5 *Muharram* 1421 A.H. (Apr. 10, 2000).

<sup>728</sup> See generally One-Stop-Shop Business Centers, Ministry of Investment, MISA.GOV.SA, <https://misa.gov.sa/en> (last visited June 07, 2021).

<sup>729</sup> See generally One-Stop-Shop Business Centers, Ministry of Investment, MISA.GOV.SA, <https://misa.gov.sa/en> (last visited June 07, 2021).

<sup>730</sup> Saudi Arabia Royal Order No. A/453, 1 *Rajab* 1441 A.H. (Feb. 25, 2020) and Saudi Arabia Ministry of Investment Statute, Ministerial Resolution No. (594) dated 13 *Shawwal* 1442 A.H. (May 25, 2021).

<sup>731</sup> Starting a Business, Doing Business, <https://archive.doingbusiness.org/en/data/exploretopics/starting-a-business> (last visited July 15, 2022).



Country : Saudi Arabia  
 Source: Doing Business  
 Created on: 07/18/2022

### 5.1.5.8 Ownership of Real Estate

Unlike in many other GCC countries, the current laws and regulations in Saudi Arabia allow foreign individuals and companies to purchase real estate for operational reasons or in order to house employees. Article 8 of the Saudi FDI Law of 2000 states, “a foreign firm licensed under this Law may acquire necessary real estate as needed for operating the licensed activity, or for housing all or some of its staff, subject to the provisions governing real estate ownership by non-Saudis.”<sup>732</sup> Licensed foreign investors in Saudi Arabia are thus generally permitted to own private housing,<sup>733</sup> industrial<sup>734</sup> and administrative<sup>735</sup> headquarters, residences

<sup>732</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (8); *see also* Law of Real Estate Ownership and Investment by Non-Saudis, Royal Decree No. M/15, 17 *Rabi Al-Thani* 1421 A.H. (July 20, 2000).

<sup>733</sup> Services Manual Eighth Edition, January 2020, Ministry of Investment, MISA.GOV.SA, <https://www.misa.gov.sa/media/1128/moi-service-manual-8th-edition-en-v4.pdf> (last visited June 07, 2021).

<sup>734</sup> *Id.*

<sup>735</sup> *Id.*

for employees, and warehouses, with one primary exception.<sup>736</sup> Foreign and non-GCC investors are prohibited from owning properties in the two holy cities of Mecca and Medina.<sup>737</sup>

#### **5.1.5.9 Free Zones**

Saudi Arabia does not currently have any free trade zones. However, in 2021, the Saudi government announced its intention to establish free zones in various regions, including the King Abdullah Financial District in Riyadh.<sup>738</sup> Like most free zones, the Saudi zones will be exempt from onshore (civil and commercial) regulations with the goal to facilitate business, encourage investment, and diversify the economy of the country. These goals are reflected in Saudi Arabia's Vision 2030 framework.

#### **5.1.6 *The United Arab Emirates***

Before 2018, foreign investments in the UAE were governed by several codes, including the UAE Commercial Companies Law of 2015 and the local tax,<sup>739</sup> agency, and customs laws of the seven emirates. In 2018, the UAE passed the Foreign Investment Law to uniformly regulate FDI.<sup>740</sup> This law was soon replaced by the amended Commercial Companies Law of 2020.<sup>741</sup> The amended law was then replaced by the new Commercial Companies Law of 2021,<sup>742</sup> which currently regulates FDI in the country.

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<sup>736</sup> *Id.*

<sup>737</sup> Law of Real Estate Ownership and Investment by Non-Saudis, Royal Decree No. M/15, 17 *Rabi Al-Thani* 1421 A.H. (July 20, 2000) *Art.* (5).

<sup>738</sup> Saudi Arabia to Launch Free Zones, FDI Intelligence, FDIINTELLIGENCE.COM, <https://www.fdiintelligence.com/article/79165> (last visited June 07, 2021).

<sup>739</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015).

<sup>740</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018).

<sup>741</sup> Amending Certain Provisions of Federal Law No. (2) of 2015 on Commercial Companies of the United Arab Emirates, Federal Law No. (26) of 2020 (Sept. 26, 2020).

<sup>742</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021).

The UAE has the largest number of free zones in the GCC region. Again, the laws and regulations that apply to those zones are different from those that apply to the rest of the country. The objective is to attract business and to facilitate trade in specific industries and sectors. The relevant laws and regulations include the Financial Free Zones Law,<sup>743</sup> the Financial Free Zones Executive Regulations,<sup>744</sup> and the separate laws of the zones. The following paragraph describes the legal framework for FDI in the UAE and the laws that apply to free zones in the country.

#### **5.1.6.1 Foreign Ownership of Capital**

Prior to the passage of the UAE FDI Law of 2018, the UAE restricted the foreign ownership of companies. Under the old Commercial Companies Law of 2015,<sup>745</sup> there were two such restrictions. First, at least 51% of the capital of each company had to be owned by a UAE national.<sup>746</sup> Therefore, a company could not be wholly owned by foreign investors, with two exceptions, which applied to GCC-country nationals (GCC investors were treated as UAE nationals)<sup>747</sup> and to branches or representative offices of foreign companies that were established in Dubai<sup>748</sup> or other emirates, such as Abu Dhabi. In these exceptional cases, the law permitted foreign investors to own all of the capital of a company.

The second restriction on company ownership under the old Commercial Companies Law of 2015 was that some commercial activities could only be performed by companies that were

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<sup>743</sup> The Financial Free Zones in the United Arab Emirates, Federal Law No. (8) of 2004 (Mar. 27, 2004).

<sup>744</sup> Implementing Regulation of the Financial Free Zones in the United Arab Emirates, Cabinet Decision No. (28) of 2007 (July 30, 2007).

<sup>745</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015).

<sup>746</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art.* (10)(1).

<sup>747</sup> Wasseem Mina, *United Arab Emirates Trade Policy Review*, 31 *WORLD ECONOMY* 1443, 1443–1453 (2008).

<sup>748</sup> *Id.*

wholly owned by UAE nationals.<sup>749</sup> The relevant sectors included commercial agency and the supply of labor.<sup>750</sup>

These two restrictions were modified by the UAE FDI Law of 2018. Under the 2018 law, foreign investors were permitted to own entire companies, even without a UAE or GCC partner, a significant change. However, such companies could only engage in certain activities included by the government on the so-called “positive list.” The cabinet of the UAE had the power to determine the content of the positive list. In 2020, the cabinet published the positive list, which included more than 100 activities in different sectors, including renewable energy, information and communications, science and technology, and healthcare.

Furthermore, the 2018 law reduced the number of activities that were prohibited to foreigners on the negative list. That list included the following items:<sup>751</sup>

- 1) the exploration and production of petroleum materials;
- 2) investigations, security, military activity, and the manufacture of arms, explosives, military equipment, military devices, and military clothing;
- 3) banking and financial activities, payment systems, and dealing with cash;
- 4) insurance services;
- 5) *hajj* (pilgrimage) and *umrah* services, including providing employment and recruitment services for staff and servants;
- 6) water and electricity services;
- 7) fisheries-related services;

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<sup>749</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art.* (10)(2).

<sup>750</sup> *See Id. and* KRISTIAN ULRICHSEN, *THE UNITED ARAB EMIRATES: POWER, POLITICS AND POLICYMAKING* at 158 (2017).

<sup>751</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (7)(2).

- 8) postal, telecommunication, and audiovisual services;
- 9) land and air transport services;
- 10) printing and publishing services;
- 11) commercial agency;
- 12) forms of medical retail, such as private pharmacies; and
- 13) blood banks, poison centers, and quarantine centers.

The 2018 law also stated that “the Council of Ministers may, by a resolution it issues, add to or remove from the Negative List ... any sectors or activities.”<sup>752</sup> In short, the Council retained the legislative discretion to modify the negative list at any time.

After the amended Commercial Companies Law was passed in 2020, almost all restrictions on capital ownership were removed. The law allowed full foreign ownership for all activities, with a single exception for activities with a “strategic impact.”<sup>753</sup> However, the law did not define “strategic impact.” The meaning of the term was to be determined by a Council of Ministers decision, which would be based on the recommendation of a special committee that would control the licensing of companies that engage in activities with a strategic impact.<sup>754</sup>

Moreover, Article 10(4) of the amended Commercial Companies Law of 2020 stated that “[t]he Council of Ministers may, at the request of the Ministry or the concerned authority, or the Competent Authority, as the case may be, exempt any Company whose activities are regulated under a special legislation, from any condition or text relating to the percentage of

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<sup>752</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (7)(2).

<sup>753</sup> Amending Certain Provisions of Federal Law No. (2) of 2015 on Commercial Companies of the United Arab Emirates, Federal Law No. (26) of 2020 (Sept. 26, 2020) *Art.* (10).

<sup>754</sup> *Id.*

nationals' ownership or participation in the management of that Company.”<sup>755</sup> Therefore, the share of foreign capital ownership of any company could be determined by the Council of Ministers.

The new Commercial Companies Law passed in 2021 maintained the provisions on foreign capital ownership from the amended law of 2020.<sup>756</sup> As such, the current laws of the UAE allow full foreign ownership as long as the activity of the enterprise is not strategic.<sup>757</sup> The UAE has yet to announce which activities are considered strategic.

### **5.1.6.2 Form of the Legal Entity**

Before the UAE FDI Law of 2018 came into force, the old Commercial Companies Law of 2015 contained a list of forms that were permissible for entities that benefit from foreign investment. That list referred to limited liability companies,<sup>758</sup> public joint-stock companies,<sup>759</sup> and private joint-stock companies.<sup>760</sup> Joint liability companies and simple limited partnerships were excluded.<sup>761</sup>

The old Commercial Companies Law of 2015 also allowed foreign companies to own branches or representative offices in the UAE, but it required them to appoint local agents. Article 329 of the old Commercial Companies Law stated, “The agent of a foreign company shall be a UAE national. If the agent is a company, it shall be a UAE company and all its partners shall be UAE nationals. The obligations of the agent to the company and third parties

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<sup>755</sup> Amending Certain Provisions of Federal Law No. (2) of 2015 on Commercial Companies of the United Arab Emirates, Federal Law No. (26) of 2020 (Sept. 26, 2020) *Art.* (10)(4).

<sup>756</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021).

<sup>757</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021) *Art.* (10).

<sup>758</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art.* (9) and *Art.* (10)(1).

<sup>759</sup> *Id.*

<sup>760</sup> *Id.*

<sup>761</sup> *Id.*

shall be limited to providing such services to the company, without any responsibility or financial obligations in connection with the business or activity of the branch or office of the foreign company inside the State or abroad.”<sup>762</sup>

Since the UAE FDI Law of 2018 came into force, foreign investors have been allowed to use limited liability companies and private joint-stock companies.<sup>763</sup> Both can be owned by a single individual. However, the law still imposes formal requirements on foreign companies, in particular when it comes to their names. Article 10(1)(d) states, “The name of a Foreign Investment Company shall be accompanied by its legal form and the words ‘foreign direct investment.’”<sup>764</sup> Regarding the branches of foreign companies or their representative offices, the UAE FDI Law introduced a significant change: the appointment of a UAE national as an agent is no longer necessary.

The new Commercial Companies Law of 2021 allows foreign investors to use any of the following permissible forms: a joint liability company,<sup>765</sup> limited partnership company,<sup>766</sup> limited liability company,<sup>767</sup> public joint-stock company,<sup>768</sup> or private joint-stock company.<sup>769</sup> In addition, the new Commercial Companies Law allows foreign companies to open branches and representative offices without appointing UAE nationals as agents.<sup>770</sup>

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<sup>762</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art.* (329).

<sup>763</sup> Foreign Direct Investment (FDI), The United Arab Emirates Government Portal, GOVERNMENT.AE, <https://u.ae/en/information-and-services/finance-and-investment/foreign-direct-investment> (last visited June 07, 2021).

<sup>764</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (10)(1)(D).

<sup>765</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021) *Art.* (9).

<sup>766</sup> *Id.*

<sup>767</sup> *Id.*

<sup>768</sup> *Id.*

<sup>769</sup> *Id.*

<sup>770</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021) *Art.* (336)–(339).

### 5.1.6.3 National Treatment

Before the UAE FDI Law of 2018 came into force, foreign investors did not benefit from national treatment. Article 9(3) of the old Commercial Companies Law of 2015 stated, “Every company established in the State shall bear the nationality thereof, but this does not entail that said company shall necessarily enjoy the rights exclusive to UAE nationals.”<sup>771</sup> Therefore, enterprises that were owned by foreign investors were not granted national treatment, even though the enterprises were deemed to be UAE companies.

However, the UAE FDI Law of 2018 explicitly granted national treatment to foreign investments, subject to certain exceptions. Article 8(1) stated, “Foreign Investment Companies licensed pursuant to the provisions of this Law by Decree shall be treated as national companies to the extent permitted by legislation in force in the State and international agreements to which the State is a party.”<sup>772</sup>

Following the passage of the new Commercial Companies Law of 2021, all companies incorporated in the UAE are deemed to be UAE companies. However, there is an express provision that stipulates that companies that are owned by foreigners do not enjoy the same rights as those owned by UAE nationals. Article 9(3) reads as follows: “Any company incorporated in the State shall hold the nationality thereof. Nevertheless, this shall not necessarily entail that said company enjoys rights limited to UAE nationals.”<sup>773</sup> In short, the law does not explicitly grant national treatment to foreign investors.

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<sup>771</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art. (9)(3)*.

<sup>772</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art. (8)(1)*.

<sup>773</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021) *Art. (9)(3)*.

#### 5.1.6.4 Tax

There is no federal corporate tax system in the UAE.<sup>774</sup> Six of the seven emirates—Abu Dhabi, Ajman, Dubai, Fujairah, Ras Al Khaimah, and Sharjah—have corporate income tax systems.<sup>775</sup> All companies in the UAE, including foreign firms, are exempt from paying local corporate taxes.<sup>776</sup> The only exceptions are oil companies and foreign banks.<sup>777</sup> Oil companies in the UAE are taxed at between 55% and 87% of net profits,<sup>778</sup> and branches of foreign banks are taxed at 20%.<sup>779</sup>

#### 5.1.6.5 Tariff and Customs Duty Exemptions

The UAE does not grant special treatment to foreign investors in terms of customs duties (except in free trade zones, as later detailed). Like national investors, foreign investors are liable for customs duties on imports. The duties are relatively low, typically set at 5% of the value of the goods. However, there are exceptions to this general rule. First, imports from other GCC countries are exempt from customs duties under the GCC Common Customs Law.<sup>780</sup> Therefore, GCC imports are not subject to customs duties in the UAE. Second, certain products attract higher duties. For example, imported cigarettes are subject to a 100% duty, and alcohol is subject to a 50% duty.

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<sup>774</sup> See USA INTERNATIONAL BUSINESS PUBLICATIONS, *ISLAMIC TAXATION LAW HANDBOOK* at 277 (2<sup>nd</sup> ed. 2009).

<sup>775</sup> *Id.*

<sup>776</sup> Other taxes, The United Arab Emirates Government Portal, GOVERNMENT.AE, <https://u.ae/en/information-and-services/finance-and-investment/taxation/other-taxes> (last visited June 07, 2021).

<sup>777</sup> *Id.*

<sup>778</sup> IGI GLOBAL, *HANDBOOK OF RESEARCH ON PUBLIC FINANCE IN EUROPE AND THE MENA REGION* at 174 (2016) and PKF INTERNATIONAL LIMITED, *DOING BUSINESS IN THE UAE* at 49 (2021).

<sup>779</sup> *Id.*

<sup>780</sup> Common Customs Law of the GCC States, Rules of Implementation and Explanatory Notes (2003).

### 5.1.6.6 Transferability of Capital and Repatriation of Earnings

Before the enactment of the UAE FDI Law of 2018, the old Commercial Companies Law of 2015 did not restrict the transfer of shares by foreign shareholders. This said, no transfer could result in a violation of the rule that 51% of the capital of the company had to be owned by a UAE national. In other words, a transfer could not cause the share of foreign investors to rise above 49%.<sup>781</sup>

These principles were retained by the UAE FDI Law of 2018. The law also allowed foreign investors to add partners to their companies,<sup>782</sup> to transfer ownership to other investors,<sup>783</sup> to merge them with others, and to acquire new ones.<sup>784</sup> The only requirement was to obtain written approval, if applicable, from the relevant licensing authority.<sup>785</sup>

Furthermore, the UAE FDI Law permitted foreign investors to repatriate the returns on their investments, including annual net profit,<sup>786</sup> all of the income from the liquidation of investments or their sale (partial or full),<sup>787</sup> and all money received in the settlement of investment disputes.<sup>788</sup> The law also expressly provided that the employees of foreign enterprises could transfer their salaries<sup>789</sup> and benefits outside of the UAE.<sup>790</sup>

After the passage of the new Commercial Companies Law of 2021, there is no longer a distinction between foreign and national owners. As a result, there are no special restrictions on the transferability of capital and the repatriation of earnings.

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<sup>781</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art.* (10)(3).

<sup>782</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(5)(A).

<sup>783</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(5)(B).

<sup>784</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(5)(D).

<sup>785</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(5).

<sup>786</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(2)(A).

<sup>787</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(2)(B).

<sup>788</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(2)(C).

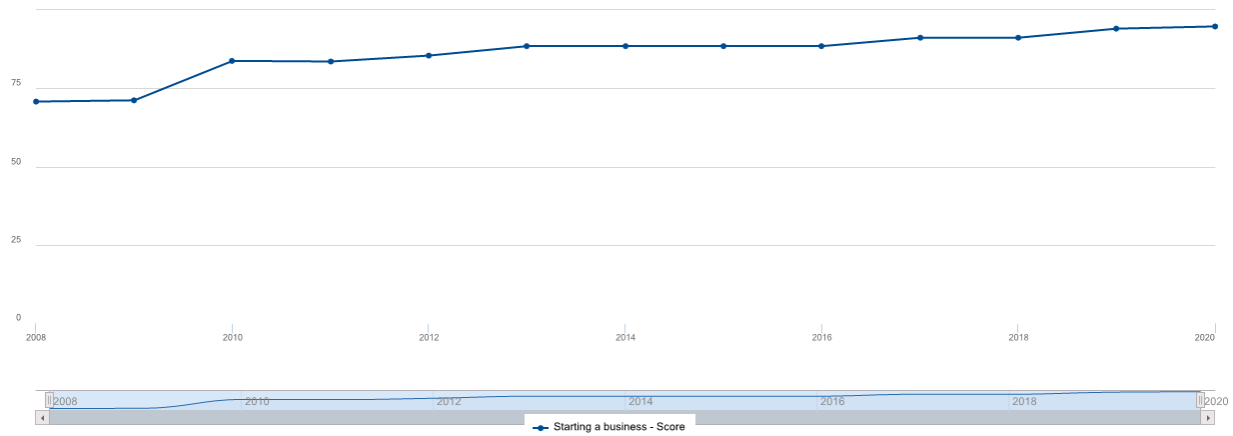
<sup>789</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(3).

<sup>790</sup> *Id.*

### 5.1.6.7 Starting a Business

In the most recent EDB report, the UAE scored 94.8 out of 100,<sup>791</sup> the highest score among all GCC countries, for the efficiency with which a business can be established in the country. This score is based on considerations of time and expense. The UAE FDI Law is the only law in the GCC that obliges investment authorities to approve complete applications in no more than five business days.<sup>792</sup> Figure 5.6 illustrates the UAE's score for the ease of starting a business between 2008 and 2020.

**Figure 5.6** *Ease of starting a business in the UAE*



Country : United Arab Emirates  
Source: Doing Business  
Created on: 07/18/2022

<sup>791</sup> Starting a Business, Doing Business, <https://archive.doingbusiness.org/en/data/exploretopics/starting-a-business> (last visited July 15, 2022).

<sup>792</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (10)(1)(C).

### 5.1.6.8 Ownership of Real Estate

The current federal system in the UAE allows each emirate to exercise a degree of autonomy over its resources as well as the freedom to improve its development model. Therefore, the rules on the foreign ownership of real estate differ slightly across emirates. Dubai, for example, is considered to be the friendliest and the most flexible emirate. Dubai depends in large part on foreign real estate purchases for its survival in the global economy.<sup>793</sup> In addition, it has limited natural resources, such as oil. It thus focuses on tourism and real estate as key sources of income.<sup>794</sup>

In 2006, Dubai announced an important decision on the ownership of real estate: as a general rule, only UAE nationals,<sup>795</sup> GCC country nationals,<sup>796</sup> companies owned fully by GCC nationals,<sup>797</sup> and public joint-stock companies<sup>798</sup> can own real estate. However, the legislature allows non-UAE citizens and non-GCC nationals to own freeholds and leaseholds in certain areas.<sup>799</sup> The terms of those leaseholds cannot exceed 99 years.<sup>800</sup>

### 5.1.6.9 Free Zones

The UAE has the highest number of free zones both in the GCC and in the entire Asia, Middle East, and North Africa (AMENA) region. There are currently 45 free zones in the UAE.<sup>801</sup> They are located in Dubai, Abu Dhabi, Sharjah, Fujairah, Ajman, Ras al Khaimah, and

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<sup>793</sup> See ABDULRAZAK ALFARIS & RAIMUNDO SOTO, THE ECONOMY OF DUBAI at 36 (2016).

<sup>794</sup> *Id.*

<sup>795</sup> Real Property Registration in the Emirate of Dubai, Law No. (7) of 2006 (Mar. 12, 2006) *Art.* (4).

<sup>796</sup> *Id.*

<sup>797</sup> *Id.*

<sup>798</sup> *Id.*

<sup>799</sup> *Id.*

<sup>800</sup> *Id.*

<sup>801</sup> Starting a Business in a Free Zone, The Official Portal of the UAE Government, <https://u.ae/en/information-and-services/business/starting-a-business-in-a-free-zone> (last visited June 07, 2021).

Um Al Quwain. However, most are in Dubai.<sup>802</sup> Each free zone is authorized to host specific businesses.<sup>803</sup>

Free zones in the UAE are subject to special regulations and rules that create a facilitating environment for business. Each free zone operates independently of the others, with distinct laws and regulations and separate authorities. Importantly, all impose few restrictions and regulations on businesses in order to encourage foreign investment in certain key industries and sectors. For example, commercial entities in the free trade zones can be wholly owned by foreigners.<sup>804</sup> They enjoy tax holidays of up to 50 years,<sup>805</sup> zero customs duties on imports,<sup>806</sup> and full repatriation rights for their profits and capital.<sup>807</sup>

The UAE hosts two of the leading financial centers and special economic zones in the Middle East, the Dubai International Financial Centre and the Abu Dhabi Global Market. Interestingly, these two areas are governed by a hybrid of civil and common law, specifically English common law.<sup>808</sup> The areas have their own courts for civil and commercial disputes, which apply the hybrid system.<sup>809</sup>

## **5.2 COMPARING AND EVALUATING THE CURRENT LEGAL FRAMEWORK THAT GOVERNS FDI IN THE GCC COUNTRIES**

The first part of this chapter surveyed the historical development of the legal frameworks that govern FDI in each GCC country. In this section, I compare the current legal frameworks

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<sup>802</sup> *Id.*

<sup>803</sup> *Id.*

<sup>804</sup> *See, e.g.*, The Dubai International Airport Free Zone, Law No. (25) of 2009 (July 13, 2009).

<sup>805</sup> *Id.*

<sup>806</sup> *Id.*

<sup>807</sup> *Id.*

<sup>808</sup> *See* The Dubai International Financial Centre (DIFC), DIFCOURTS.AE, <https://www.difccourts.ae> (last visited June 07, 2021) *and* The Abu Dhabi Global Market Courts (ADGM), ADGM.COM, <https://www.adgm.com/adgm-courts> (last visited June 07, 2021).

<sup>809</sup> *Id.*

governing FDI of those countries by reference to the nine parameters referenced in Section 5.2:

- 1) rules on the foreign ownership of capital, 2) the form of the legal entity of the foreign investment, 3) the application of the national treatment principle, 4) the corporate tax regime, 5) tariff and customs duty exemptions, 6) the transferability of capital and earnings, 7) the time and cost of starting a business, 8) real estate ownership, and 9) free zones.

### **5.2.1 Foreign Ownership of Capital**

The current regulations in the GCC countries have removed the requirement that nationals hold most of the capital of a company, except in the cases of public joint-stock companies in Qatar. The Qatari legislature restricts non-Qatari shareholdings to 49% in these companies.<sup>810</sup> This restriction may be lightened on a case-by-case basis if the Council of Ministers approves a proposal from the Minister of Finance, Economy, and Commerce.<sup>811</sup> In all other cases, full foreign ownership is permissible across the GCC.<sup>812</sup> However, each country has a negative list, which details activities in which foreign investors are not allowed to engage.

The activities on the negative lists vary in type and number from one country to another. The Omani negative list is the most extensive, comprising 70 activities. Most of these concern the manufacture of traditional items, such as desserts,<sup>813</sup> caps,<sup>814</sup> women's gowns,<sup>815</sup> and daggers.<sup>816</sup> Qatar has the shortest negative list. It prohibits foreign investors only from engaging

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<sup>810</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (7).

<sup>811</sup> *Id.*

<sup>812</sup> See Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (12) and Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art.* (8) and Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (6) and The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (2) and Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (5)(2).

<sup>813</sup> Defining the List of Activities in Which Foreign Investment is Prohibited in Oman, Ministry of Commerce, Industry and Investment Promotion Resolution No. (209) of 2020 (Dec. 8, 2020).

<sup>814</sup> *Id.*

<sup>815</sup> *Id.*

<sup>816</sup> *Id.*

in commercial agency,<sup>817</sup> banking, and insurance without the approval of the Council of Ministers.<sup>818</sup> The remaining GCC countries—Bahrain, Kuwait, and Saudi Arabia—have between 10 and 13 activities on their negative lists.<sup>819</sup> At the time of writing, the UAE has not published its list of restricted strategic activities. Therefore, it is difficult to evaluate its length and its content.

It is worth noting that some GCC countries, such as Qatar, have retained the right to modify their negative lists at any time. For example, the Qatari law that states, “It is prohibited for non-Qatari investors to invest in the following fields . . . c. [and] any other fields for which a decision from the Council of Ministers is issued.”<sup>820</sup> In addition, some countries have adopted a positive approach, seeking to reduce the number of activities on their lists. For example, Article 3 of the Implementing Regulations of the Saudi FDI Law states, “The Board of Directors shall periodically review the list of activities excluded from foreign investment in order to shorten it and submit it to the Council to consider its approval.”<sup>821</sup>

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<sup>817</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (4).

<sup>818</sup> *Id.*

<sup>819</sup> For the list of activities under the negative list for GCC countries, *see supra* Chapter 4.

<sup>820</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (4).

<sup>821</sup> Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (3).

## 5.2.2

### *Form of the Legal Entity of the Foreign Investment*

Bahrain, Oman, Qatar, and the UAE do not require foreign investment companies to adopt specific forms.<sup>822</sup> In these countries, foreign enterprises may be structured in any way that is permissible under domestic law.<sup>823</sup>

In contrast, Kuwait and Saudi Arabia oblige foreign investment companies to adopt specific forms. Kuwait allows wholly foreign-owned businesses to take the form of shareholding companies,<sup>824</sup> limited liability companies,<sup>825</sup> or single-person companies.<sup>826</sup> Saudi Arabia restricts enterprises that are wholly owned by foreign investors to the forms of limited liability companies<sup>827</sup> and joint-stock companies.<sup>828</sup> However, the legislature gives the Ministry of Investment the right to approve the use of other forms.<sup>829</sup>

## 5.2.3

### *National Treatment Principle*

Among the GCC countries, only Oman and Saudi Arabia explicitly extend national treatment to foreign investors;<sup>830</sup> Bahrain, Kuwait, Qatar, and the UAE do not. However, while Oman and

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<sup>822</sup> Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *and* the Ministry of Industry, Commerce and Tourism Kingdom of Bahrain, Procedures Guide for Establishments and Commercial Companies, <https://www.moic.gov.bh/en/Tiles/BusinessServices/Commercial%20Registration%20and%20Companies%20Control/Guidelines/Documents/amended%20Procedures%20Guide%20for%20Establishments%20and%20Commercial%20Companies%20%28002%29.pdf> (last visited Nov. 25, 2021) *and* Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13<sup>th</sup>, 2019) *Art.* (4) *and* Qatar Commercial Companies Law, Law No. (11) of 2015 (July 7, 2015) *Art.* (4) *and* The Commercial Companies Law of the United Arab Emirates, Federal Law No. (2) of 2015 (Apr. 1, 2015) *Art.* (9) *and Art.* (10)(1).

<sup>823</sup> For the forms of companies in Bahrain, Oman, and Qatar see Bahrain Commercial Companies Law, Decree Law No. (21) of 2001 (June 20, 2001) *Art.* (2) *and* Oman Commercial Companies Law, Sultani Decree No. (18) of 2019 (Feb. 13<sup>th</sup>, 2019) *Art.* (4) *and* Qatar Commercial Companies Law, Law No. (11) of 2015 (July 7, 2015) *Art.* (4).

<sup>824</sup> Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art.* (8).

<sup>825</sup> *Id.*

<sup>826</sup> *Id.*

<sup>827</sup> Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (4)(2).

<sup>828</sup> *Id.*

<sup>829</sup> *Id.*

<sup>830</sup> See Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (18) *and* Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (4)(2).

Saudi Arabia grant national treatment to foreign investors, the relevant provisions permit exceptions. The Omani law states, “An investment project shall enjoy all the benefits, incentives, and guarantees enjoyed by a national project *in accordance with the laws in force* [emphasis added] in the Sultanate.”<sup>831</sup> Meanwhile, the Saudi Law stipulates that “[t]he enterprise licensed under this Law shall enjoy all the benefits, incentives and guarantees extended to a national enterprise *according to laws and directives* [emphasis added].”<sup>832</sup>

Therefore, although the two countries as a general rule treat foreign investors and nationals in the same way, this principle is subject to other laws and regulations. Thus, if a country has special laws and regulations for foreign investors, such as those related to taxes and real estate ownership, foreign investors will be subject to distinct rules and thereby not benefit from national treatment. Indeed, Saudi Arabia taxes foreign and domestic investors differently, and in Oman, there are restrictions on the foreign ownership of real estate.

#### **5.2.4 Corporate Tax Regime**

Corporate taxation differs across the GCC countries. Three approaches may be discerned. First, foreign and national investments may be treated in the same manner. Second, foreign investors may be favored, such as through tax holidays that do not apply to national companies. Third, different tax rates may apply to national and foreign investors.

Bahrain, the UAE, and Oman have adopted the first approach. National and foreign investors are treated in the same manner, so there is no special treatment for foreign investments. Therefore, any tax exemptions are applied to all investors, be they nationals or foreigners. The same is true if there are no tax exemptions—they apply to neither national nor foreign investors.

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<sup>831</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (18).

<sup>832</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (6).

Bahrain and the UAE make the same tax exemptions available to all companies. Both countries levy corporate taxes on certain commercial activities. In Bahrain, companies that engage in the exploration, production, or refining of oil and hydrocarbons, whether national or foreign, are subject to a 46% corporate tax.<sup>833</sup> In the UAE, oil companies are taxed at between 55% and 87% of net profits,<sup>834</sup> and branches of foreign banks are taxed at 20%.<sup>835</sup>

Oman also treats foreign and national investments in the same manner. However, unlike in Bahrain and the UAE, in Oman, the current regulations do not grant exemptions to national and foreign investors.<sup>836</sup> All investors are taxed in the same manner. As mentioned in 5.1.3.4, tax rates differ between activities. The tax rate for most sectors is 15%.<sup>837</sup> For petroleum exploration, it is 55%.<sup>838</sup> (see 5.1.3.4 for the different tax rates and the activities that are exempt from corporate tax).

The second approach to corporate tax in the GCC entails prioritizing foreign investors through occasional tax exemptions that are not available to national investors. Kuwait and Qatar adopt this approach. In these countries, exemptions are at the discretion of the respective foreign investment administrations.<sup>839</sup> The Kuwaiti law states, “The Investor *shall be* [emphasis added] entitled to some or all of the following incentives.”<sup>840</sup> One of the incentives enumerated in the full text refers to all types of taxes.<sup>841</sup> Meanwhile, the Qatari law states, “Non-Qatari Investment

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<sup>833</sup> Bahrain Income Tax Law, Decree Law No. (22) of 1979 (Nov. 28, 1979) *Art.* (2).

<sup>834</sup> IGI GLOBAL, HANDBOOK OF RESEARCH ON PUBLIC FINANCE IN EUROPE AND THE MENA REGION at 174 (2016) and PKF INTERNATIONAL LIMITED, DOING BUSINESS IN THE UAE at 49 (2021).

<sup>835</sup> *Id.*

<sup>836</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (112).

<sup>837</sup> *Id.*

<sup>838</sup> Oman Income Tax Law, Sultani Decree No. (118) of 2020 (Sept. 14, 2020) *Art.* (114).

<sup>839</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (27) and The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (10).

<sup>840</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (27).

<sup>841</sup> *Id.* at *Art.* (27)(1).

projects *may be exempted* [emphasis added] from income tax in accordance with controls, procedures and periods provided in the aforementioned Law of Income Tax.”<sup>842</sup>

Whereas the duration of tax exemptions in Kuwait is restricted to 10 years, Qatari law does not specify a maximum period.<sup>843</sup> Instead, the law states that the foreign investment administration can specify the period for which foreign investors are exempt from taxes.<sup>844</sup> Therefore, exemptions are applied on a case-by-case basis in both Kuwait and Qatar.

The third approach to corporate tax in the GCC countries involves applying different tax rates to national and foreign investors. This approach is adopted by the Saudi legislature. Even when an investment is co-owned by Saudi and non-Saudi partners, the capital of the Saudi partners is taxed differently from the capital of the foreign partners. As noted in 5.1.5.4, wholly Saudi-owned investments are taxed at the *zakat* rate, 2.5% of the net profit of the company.<sup>845</sup> Wholly foreign-owned investments are taxed at 20%.<sup>846</sup> Investments that are co-owned by Saudi and non-Saudi partners are taxed at the *zakat* rate for the Saudi capital and at 20% of net adjusted profits for the non-Saudi capital.<sup>847</sup>

### 5.2.5 *Tariff and Customs Duty Exemptions*

The GCC countries adopt two distinct approaches to tariff and customs duty exemptions for foreign investors. The first approach is to offer no special treatment to foreign investors, and the second approach is to favor foreign investment by providing customs exemptions for specific imports that are not available to domestic investors.

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<sup>842</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (10).

<sup>843</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (27)(1).

<sup>844</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (10).

<sup>845</sup> Implementing Regulation of the Saudi Arabia Zakat Collection, Ministerial Resolution No. (2216), 7 *Rajab* 1440 A.H. (Mar. 14, 2019) *Art.* (2).

<sup>846</sup> Saudi Arabia Income Tax Law, Royal Decree No. M/1, 15 *Muharram* 1425 A.H. (Mar. 7, 2004) *Art.* (2).

<sup>847</sup> *Id.* and Implementing Regulation of the Saudi Arabia Zakat Collection, Ministerial Resolution No. (2216), 7 *Rajab* 1440 A.H. (Mar. 14, 2019) *Art.* (14).

The first approach has been adopted in Bahrain, Saudi Arabia, and the UAE. These countries offer no special tariff or customs exemptions to foreign investors. National and foreign investors are treated alike and are obliged to pay the required tariffs on imports. An exception applies to imported materials that are necessary for industrial production—such as machinery, equipment, raw materials, and semi-manufactured materials, which are exempt from tariffs.<sup>848</sup> This exemption applies to both national and non-national investors. Therefore, the three countries require all investors to pay the same tariffs.

The second approach has been adopted in Kuwait and Qatar. Kuwaiti and Qatari laws state that foreign investors may enjoy customs duty exemptions for certain goods. In Kuwait, the law states, “The Investor *shall be* [emphasis added] entitled to some or all of the following incentives.”<sup>849</sup> One of the incentives is complete or partial customs duty exemptions. However, the exemptions only apply to the following imports:<sup>850</sup>

- 1) machinery, tools, equipment, means of transport, and other technological devices;
- 2) spare parts and maintenance supplies that are necessary for the activities in the preceding subsection; and
- 3) intermediate goods, raw materials, partially manufactured goods, and wrapping and packaging materials and supplies.<sup>851</sup>

Moreover, the maximum duration of those exemptions is limited to 10 years.<sup>852</sup>

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<sup>848</sup> Amended Controls for Exemption of Industry Inputs from Customs Taxes “Duties” in GCC Member States (2009) *Art. (2)* and Common Customs Law of the GCC States, Rules of Implementation and Explanatory Notes (2003).

<sup>849</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art. (27)*.

<sup>850</sup> *Id.* at *Art. (27)(3)* and Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art. (28)*.

<sup>851</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art. (27)(3)* and Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art. (28)*.

<sup>852</sup> Executive Regulations Implementing of the Promotion of Direct Investment Law in the State of Kuwait, Ministerial Decision No. (502) of 2014 (Dec. 7, 2014) *Art. (32)*.

In Qatar, the customs duty exemptions that are granted to foreign investors<sup>853</sup> are not subject to the discretion of the government, unlike in Kuwait. The Qatari law exempts the following imports from customs duties: i) equipment and machinery that is needed to initiate foreign investment projects<sup>854</sup> and ii) raw or semi-manufactured materials that are necessary for foreign industry and are unavailable on the Qatari market.<sup>855</sup>

Finally, the new Omani FDI Law refers to implementing regulations that identify investment projects that may be exempt from customs duties and the duration of the exemptions.<sup>856</sup> However, as the implementing regulations in question are not yet issued, it is difficult to determine the Omani approach to customs duties and foreign investment.

### **5.2.6 *Transferability of Capital and Earnings***

The current laws and regulations in the GCC countries do not restrict the transfer of foreign capital. Furthermore, foreign investors in the GCC countries can repatriate the proceeds of their investments,<sup>857</sup> including i) proceeds from sales and the liquidation of investments, ii) proceeds from the settlement of investment disputes, iii) compensation for public-benefit expropriation, and iv) the entitlements and savings of foreign employees.<sup>858</sup> Therefore, transferring capital and earnings is not a concern for foreign investors in the GCC countries.

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<sup>853</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (11).

<sup>854</sup> *Id.*

<sup>855</sup> *Id.*

<sup>856</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (20).

<sup>857</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (22) and Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (26) and The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (14) and (15) and Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (7) and Implementing Regulation of the Saudi Arabia Foreign Investment Law, Ministerial Resolution No. (2/74), 12 *Jumada Al-Ula* 1435 A.H. (Mar. 14, 2014) *Art.* (5)(5) and United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8).

<sup>858</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (22) and United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018 (Sept. 23, 2018) *Art.* (8)(2)(A).

### **5.2.7** *Time and Costs for Starting a Business*

The EDB report ranks countries on the basis of the average time expended and cost incurred in starting a business on a scale of 0 to 100, where 100 is the ideal score. All GCC countries rank highly. According to the most recent EDB report, among the GCC countries, the UAE scored the highest (94.8), followed by Oman (93.5) and Saudi Arabia (93). Bahrain, Kuwait, and Qatar received scores of 89.6, 88.4, and 86.1, respectively. The scores of all GCC countries indicate below-average bureaucratic burdens on new businesses.

### **5.2.8** *Real Estate Ownership*

As far as the ownership of real estate by natural or legal foreign persons is concerned, there are three approaches in the GCC. Some countries allow foreigners to own real estate, others limit foreign ownership to certain designated areas, and others altogether prohibit foreigners from owning real estate.

Saudi Arabia and the UAE have adopted the first approach. The Saudi FDI Law explicitly states that foreign individuals and companies are allowed to own real estate, whether for commercial operations or for employee housing.<sup>859</sup> The only exception to this rule is that non-GCC investors are not permitted to own real estate in the two holy cities of Mecca and Medina.<sup>860</sup>

Bahrain, Qatar, and Oman have adopted the second approach. The three countries allow foreigners to own real estate only in areas that are designated for foreigners. In Bahrain, these areas are residential properties in Zoning Areas A, B, and C as well as special tourism and

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<sup>859</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000) *Art.* (8); *see also* Law of Real Estate Ownership and Investment by Non-Saudis, Royal Decree No. M/15, 17 *Rabi Al-Thani* 1421 A.H. (July 20, 2000).

<sup>860</sup> Law of Real Estate Ownership and Investment by Non-Saudis, Royal Decree No. M/15, 17 *Rabi Al-Thani* 1421 A.H. (July 20, 2000) *Art.* (5).

investment projects (subject to the approval of the Ministerial Committee for Public Utilities).<sup>861</sup>

In Qatar, these areas include the Pearl, the West Bay Lagoon, and some parts of Al Khor.<sup>862</sup>

Moreover, Qatari law permits foreign investors to enter into long-term rental arrangements for the land that they need by either leasing or usufruct.<sup>863</sup>

The Omani FDI Law similarly allows foreign investors to obtain long-term leases or usufructs,<sup>864</sup> but is silent on the foreign ownership of real estate. However, in 2018, the Omani legislature passed a law that prohibits non-Omanis from owning real estate in certain parts of the country.<sup>865</sup> Therefore, foreigners in Qatar and Oman are allowed to enter into long-term leases or usufructs and to purchase real estate in designated areas.

The last approach, which prohibits foreigners from owning real estate, has been adopted in Kuwait. In Kuwait, this prohibition also applies to companies with non-Kuwaiti partners,<sup>866</sup> though an exception is made for joint-stock companies with non-Kuwaiti partners.<sup>867</sup> In this case, companies may own real estate for administrative purposes and to fulfill their objectives,<sup>868</sup> subject to the approval of the Kuwaiti authorities.<sup>869</sup> The Kuwaiti FDI law may also give foreign investors the right to use real estate for investment purposes.<sup>870</sup>

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<sup>861</sup> Non-Bahraini Ownership of Real Estate and Lands in the Kingdom of Bahrain, Legislative Decree No. (67) of 2006 (Dec. 13<sup>th</sup>, 2006) *Art.* (1).

<sup>862</sup> The Organization of Ownership and Use of Real Estate and Residential Units by Non-Qataris, Cabinet Decision No. (20) of 2004 (June 30, 2004) *Art.* (1) and Specifying the Areas in which Non-Qataris May Own and Use the Real Estate, and the Conditions, Controls, Benefits and Procedures for their Ownership and Use thereof, Cabinet Decision No. (28) of 2020 (Aug. 30, 2020).

<sup>863</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019) *Art.* (8).

<sup>864</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019) *Art.* (19).

<sup>865</sup> Organizational Regulation of Real Estate Investment Funds in Oman, Ministry of Housing, Ministerial Decision No. (95) of 2017 (Nov. 15, 2017).

<sup>866</sup> Regulating the Ownership of Real Estate by Non-Kuwaitis, Law No. (74) of 1979 (Nov. 14, 1979) *Art.* (8).

<sup>867</sup> *Id.*

<sup>868</sup> *Id.*

<sup>869</sup> *Id.*

<sup>870</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013) *Art.* (27)(4).

## 5.2.9

### *Free Trade Zones*

In the GCC countries, free trade zones are subject to specific regulations that are intended to create a business environment that is more permissive and business-friendly than in other parts of the country. These rules include permitting full foreign ownership of company capital, corporate tax holidays, personal income tax exceptions, zero customs duties on imports, and unrestricted repatriation of capital, profit, and dividends. As the regulations in these zones are less stringent than the rest of the country, they are assumed to attract more FDI inflows.<sup>871</sup>

The number of free trade zones in the GCC countries has increased over time. At the time of writing, the UAE has the highest number of free trade zones (45) in the GCC region and in the whole of AMENA.<sup>872</sup> The other GCC countries also operate many free trade zones. Qatar has four: the Umm Al Houl Free Zone, the Ras Bu Fontas Free Zone, the Qatar Financial Centre, and the Qatar Science and Technology Park.<sup>873</sup> Bahrain has three: the Bahrain Logistics Zone,<sup>874</sup> the Bahrain International Investment Park,<sup>875</sup> and Bahrain International Airport. Oman also has three free zones—the Al Mazunah Free Zone,<sup>876</sup> the Salalah Free Zone,<sup>877</sup> and the Sohar Free Zone<sup>878</sup>—as well as two special economic zones, the Duqm Special Economic Zone and the Knowledge Oasis Muscat.<sup>879</sup> Kuwait has one free trade zone, Shuwaikh Port. Finally, Saudi

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<sup>871</sup> See generally Koichi Hamada, *An Economic Analysis of the Duty-Free Zone*, 4 JOURNAL OF INTERNATIONAL ECONOMICS 225, 225–241 (1974) and Michael Fodor, *Free Zones: Benefits and Costs*, 275 ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, THE OECD OBSERVER 19, 19–21 (2009).

<sup>872</sup> Starting a Business in a Free Zone, The Official Portal of the UAE Government, <https://u.ae/en/information-and-services/business/starting-a-business-in-a-free-zone> (last visited June 07, 2021).

<sup>873</sup> Qatar Investment Free Zones, Law No. (34) of 2005 (Dec. 29, 2005) and Qatar Financial Centre Law, Law No. (7) of 2005 (Mar. 3, 2005) and Amending Certain Provisions of the Qatar Financial Centre (QFC) Law as Promulgated by Law No. (7) of 2005, Law No. (2) of 2009 (Feb. 2, 2009) and Establishing a Free Zone for Qatar Science and Technology Park, Law No. (36) of 2005 (Sept. 26, 2005).

<sup>874</sup> See Ministry of Transportation and Telecommunications, Bahrain Logistics Zone, <https://www.mtt.gov.bh/content/pma-bahrain-logistics-zone> (last visited Nov. 19, 2021).

<sup>875</sup> See Bahrain International Investment Park, <https://www.biip.com.bh/incentives>, (last visited Nov. 19, 2021).

<sup>876</sup> Al Mazunah Free Zone Law, Sultani Decree No. (103) of 2005 (Dec. 21, 2005).

<sup>877</sup> Salalah Free Zone Law, Sultani Decree No. (62) of 2006 (June 20, 2006).

<sup>878</sup> Sohar Free Zone Law, Sultani Decree No. (123) of 2010 (Dec. 21, 2010).

<sup>879</sup> Duqm Special Economic Zone Law, Sultani Decree No. (119) of 2011 (Oct. 26, 2011).

Arabia has not started operating free trade zones, but government officials have announced that two such zones will soon be established.<sup>880</sup>

Table 5.1 below summarizes and compares the current FDI legal frameworks of the six GCC countries. It is evident that Kuwait is the GCC country with the most restrictive legal environment for FDI, while the UAE has the least restrictive environment.

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<sup>880</sup> Saudi Arabia to Launch Free Zones, FDI Intelligence, FDIINTELLIGENCE.COM, <https://www.fdiintelligence.com/article/79165> (last visited June 07, 2021).

**Table 5.1** Summary of the current foreign direct investment legal framework in Gulf Cooperation Council countries

	<b>Bahrain</b>	<b>Kuwait</b>	<b>Oman</b>	<b>Qatar</b>	<b>KSA</b>	<b>UAE</b>
<b>Foreign ownership of capital</b>	Allows 100% ownership except for activities on a negative list	Allows 100% ownership except for activities on a negative list	Allows 100% ownership except for activities on a negative list	Allows 100% ownership except for activities on a negative list and in the case of joint-stock companies	Allows 100% ownership except for activities on a negative list	Allows 100% ownership except for strategic activities
<b>Form of the legal entity of the foreign investor</b>	Any form	Restricted forms	Any form	Restricted forms	Restricted forms	Any form
<b>National treatment principle</b>	Not explicitly granted	Not explicitly granted	Foreign investors enjoy the following: 1) national treatment 2) preferential treatment by decision of the Council of Ministers on the basis of a recommendation by the Minister of Finance, Economy, and Commerce	Not explicitly granted	Grants national treatment to foreign investors	Not explicitly granted
<b>Corporate tax regime</b>	Treats foreign and national investments in the same way, with tax exemptions available for almost all activities	Favors foreign investors by granting them tax holidays that are generally unavailable to domestic companies	Treats foreign and national investments in the same manner. No tax exemptions for either national or foreign investors	Favors foreign investors by granting them tax holidays that are generally unavailable to	Applies different tax rates to domestic and foreign investors	Treats foreign and domestic investments in the same manner, with tax exemptions for almost all activities

				domestic companies		
<b>Tariff and customs duty exemptions</b>	Treats foreign and national investors in the same manner	May provide customs exemptions (partial or full) for specific imports to foreign investors and not to domestic ones for up to 10 years	Law not passed yet	Customs exemptions for specific imports that are not available to domestic investors	Treats foreign and national investments in the same manner	Treats foreign and domestic investments in the same manner
<b>Transferability of capital and earnings</b>	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions
<b>Time and cost of starting a business</b>	89.6/100	88.4/100	93.5/100	93.5/100	93/100	94.8/100
<b>Real estate ownership</b>	Limits foreign ownership of real estate to certain designated areas	Prohibits foreigners from owning real estate but gives foreign investors the right to use real estate for investment purposes	Prohibit foreigners from owning real estate but may allow long-term leases or usufructs in designated areas	Limits foreign ownership of real estate to certain designated areas	Allows foreigners to own real estate	Allows foreigners to own real estate
<b>Free zones</b>	3	1	5	4	0	45

## Chapter 6. DETERMINANTS OF FDI IN THE GCC COUNTRIES

*This dissertation aims to address the relationship between business-facilitating legal institutions and FDI inflows to the GCC countries. Because legal factors account for only some of the determinants of FDI, this chapter first answers the third sub-question, which requires the identification of the determinants of FDI in the GCC countries. The exposition then turns to the central question of the thesis, which is whether business-facilitating legal institutions play a role in attracting FDI to the GCC countries. The study employs time-series cross-section analyses to answer the two questions. This chapter outlines the research methodology, design, variables, data sources, descriptive statistics, estimation models, and regression results. Finally, the discussion section answers both the third sub-question and the primary research question.*

### 6.1 METHODOLOGICAL BACKGROUND

In this study, I use quantitative panel-data analysis, which is also called time-series cross-section analysis.<sup>881</sup> Before discussing the design of the research in depth, I provide background information about panel data and different estimation models.

#### 6.1.1 *Panel-Data Analysis*

Panel data are multiple observations of a set of units or individuals (N)—such as countries,<sup>882</sup> firms,<sup>883</sup> groups, and individuals<sup>884</sup>—over a series of time points (T).<sup>885</sup> The analysis

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<sup>881</sup> Time series cross-section is specifically used to indicate panels with small units (N) and large series of time points (T), whereas panel data are often used for large N and low T. However, in this study the terms are used interchangeably. See HENNING BEST & CHRISTOF WOLF, *THE SAGE HANDBOOK OF REGRESSION ANALYSIS AND CAUSAL INFERENCE* at 388 (2015).

<sup>882</sup> HANS-JÜRGEN ANDREß ET AL., *APPLIED PANEL DATA ANALYSIS FOR ECONOMIC AND SOCIAL SURVEYS* at 119 (2013)

<sup>883</sup> *Id.*

<sup>884</sup> *Id.*

<sup>885</sup> JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 6-7 (2<sup>nd</sup> ed. 2010).

of panel data can be understood as a mixture of cross-section analysis and time-series analysis.<sup>886</sup> Cross-section analysis concerns observations of multiple different units at a particular point in time.<sup>887</sup> Time-series analysis focuses on a single unit at multiple time intervals to determine how the variables of interest explain the unit change over time.<sup>888</sup> Panel-data analysis, as a hybrid, is similar to cross-section analysis in that it allows observation of different units, and to time-series analysis in that the observations may occur over a period of time.

The primary benefits of panel-data analysis are as follows: 1) it is suitable for studies of dynamic relationships between units and variables that vary over time;<sup>889</sup> 2) it allows the researcher to control for unobserved heterogeneity across units,<sup>890</sup> as discussed in paragraphs 6.1.2.2 and 6.1.2.3; and 3) it is a useful mode of analysis when addressing the problem of missing or omitted data.<sup>891</sup>

### **6.1.2** *Estimation Models for Panel Data*

There are multiple models for analyzing panel data. The most common models are pooled ordinary least squares, fixed effects, and random effects. The choice of model depends on the objective of the analysis and the assumption of unobserved heterogeneity across units. The term “heterogeneity,” which is the opposite of “homogeneity,” refers to differences across individuals in a sample. The individuals in a sample may exhibit unobserved heterogeneity, which is not captured by the explanatory variables and affects the outcome variable. Omitting such variables

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<sup>886</sup> EDWARD W. FREES, *LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES* at 2 (2004).

<sup>887</sup> SIMONETTA LONGHI & ALITA NANDI, *A PRACTICAL GUIDE TO USING PANEL DATA* at 3 (2014).

<sup>888</sup> *Id.*

<sup>889</sup> *Id.* and JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 169 (2<sup>nd</sup> ed. 2010).

<sup>890</sup> SIMONETTA LONGHI & ALITA NANDI, *A PRACTICAL GUIDE TO USING PANEL DATA* at 3-4 (2014) and A. COLIN CAMERON & PRAVIN K. TRIVEDI, *REGRESSION ANALYSIS OF COUNT DATA* at 341 (2<sup>nd</sup> ed. 2013) and JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 169 (2<sup>nd</sup> ed. 2010).

<sup>891</sup> JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 281 (2<sup>nd</sup> ed. 2010).

or failing to control for them leads to bias in the resulting estimates (i.e., differences between the estimated sample mean and the true population mean).<sup>892</sup> This unobserved heterogeneity can take two forms: *individual-specific unobserved heterogeneity* and *time-specific unobserved heterogeneity*.

*Individual-specific unobserved heterogeneity* captures different unobserved characteristics that are constant for a given individual over time but are different for other individuals in the dataset (unit-specific time-invariant confounders<sup>893</sup>). Examples include geographical location, culture, and economic factors that are constant for a particular individual, but vary in the sample. *Time-specific unobserved heterogeneity* refers to variation in unobserved factors that occurs at a certain point in time and affects all units.<sup>894</sup> Examples of this time-specific effect include economic or political incidents that affect all countries in a sample at a particular point in time.

Given that it is almost impossible to list all sources of unobserved heterogeneity, whether individual- or time-specific, panel-data analyses are helpful because they enable the introduction of controls for unobserved heterogeneity.<sup>895</sup> Panel data contain observations of units across different time points. These repeated observations facilitate the use of controls for unobserved heterogeneity that has nonzero covariance with the explanatory variables and the elimination of its effects.<sup>896</sup> When one of the unobserved heterogeneities, which can be individual- or time-

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<sup>892</sup> See HANS-JÜRGEN ANDREß ET AL., *APPLIED PANEL DATA ANALYSIS FOR ECONOMIC AND SOCIAL SURVEYS* at 123 (2013).

<sup>893</sup> Confounders are variables that affect the independent or dependent variables. See STANTON A. GLANTZ AND BRYAN K. SLINKER, *PRIMER OF APPLIED REGRESSION & ANALYSIS OF VARIANCE* at 515 (2<sup>nd</sup> ed. 2001).

<sup>894</sup> MICHAEL A. THORNTON, NIGAR HASHIMZADE, *HANDBOOK OF RESEARCH METHODS AND APPLICATIONS IN EMPIRICAL MICROECONOMICS* at 281 (2021) and LÁSZLO MÁTYÁS, *THE ECONOMETRICS OF PANEL DATA: FUNDAMENTALS AND RECENT DEVELOPMENTS IN THEORY AND PRACTICE* at 64 (3<sup>rd</sup> ed. 2008).

<sup>895</sup> BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 4-5 (3<sup>rd</sup> ed. 2005) and CHENG HSIAO, *ANALYSIS OF PANEL DATA* at 4 (1<sup>st</sup> ed. 1986).

<sup>896</sup> See CHENG HSIAO, *ANALYSIS OF PANEL DATA* at 3-4 (1<sup>st</sup> ed. 1986).

specific, is accounted for in the estimation model, the model is called a one-way model.<sup>897</sup> When the model accounts for both individual- and time-specific unobserved heterogeneity, it is called a two-way model.<sup>898</sup>

Different panel-data estimation models are premised on different assumptions about unobserved heterogeneity. Pooled ordinary least squares models treat all units as if there are no differences between them.<sup>899</sup> The fixed-effects model assumes that the unobserved heterogeneities are parameters that should be estimated for each unit.<sup>900</sup> This assumption is reflected in the use of a dummy variable that represents the different intercepts of the regression line for each individual in the sample and is designed on the assumption that the intercepts are correlated to the explanatory variables. Finally, the random-effects model assumes that unobserved heterogeneity is measured as a random variable that is drawn from a larger population<sup>901</sup> and is uncorrelated to the explanatory variables.<sup>902</sup> The following paragraphs address each of these models and the differences between them.

### 6.1.2.1 Pooled Ordinary Least Squares

Pooled ordinary least squares, also known as “the common constant method,”<sup>903</sup> is the simplest model for analyzing panel data. The term “pooled” refers to the treatment of the panel data as a single aggregated dataset.<sup>904</sup> The common constant method assumes that there is no

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<sup>897</sup> See BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 11-12 (3<sup>rd</sup> ed. 2005).

<sup>898</sup> See *Id.* at 33-34.

<sup>899</sup> DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 443 (3<sup>rd</sup> ed. 2015).

<sup>900</sup> JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 251 (1<sup>st</sup> ed. 2002).

<sup>901</sup> MARN VERBEEK, *A GUIDE TO MODERN ECONOMETRICS* at 310 (2000) and CHENG HSIAO, *ANALYSIS OF PANEL DATA* at 32-33 (1<sup>st</sup> ed. 1986).

<sup>902</sup> BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 14 (3<sup>rd</sup> ed. 2005) and DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 446 (3<sup>rd</sup> ed. 2015).

<sup>903</sup> DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 443 (3<sup>rd</sup> ed. 2015).

<sup>904</sup> See JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 150 (2<sup>nd</sup> ed. 2010).

difference between the matrices of the units.<sup>905</sup> This model treats all observation as if they refer to the same unit. It does so by stacking all data in one long regression with  $NT$  observations,<sup>906</sup> where  $N$  is the number of units and  $T$  denotes time periods. The regression is then estimated by using ordinary least squares on the assumption that the intercept is the same for all observations.<sup>907</sup> For example, in a panel with  $N = 6$  countries and  $T = 10$  years, there are  $NT = 60$  observations. The pooled ordinary least squares method stacks all 60 observations ( $NT$ ) in one regression and treats them as if there is no difference between the countries. As a result, the coefficient for the explanatory variable  $x$  (e.g., the quality of law) represents the average marginal effect of  $x$  on  $y$  across all observations, without accounting for unobserved heterogeneity across units or times, which may affect the coefficient.

The regression equation for this model is as follows:

$$y_{it} = \beta_0 + \beta_1 x_{1,it} + \dots + \beta_k x_{k,it} + \varepsilon_{it},$$

where  $y_{it}$  refers to the dependent variable for unit  $i$  at time point  $t$ .  $\beta_0$  refers to the intercept and is identical for all units.  $\beta_1, \dots, \beta_k$ , is the set of coefficients to be estimated.  $x_{1,it}, \dots, x_{k,it}$  refers to a set of explanatory variables for unit  $i$  at time point  $t$ , and  $\varepsilon_{it}$  is the error term.

In general, this model is not suitable for analyzing panel data because it ignores its structure.<sup>908</sup> Pooled ordinary least squares analysis fails to exploit important advantages of panel

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<sup>905</sup> DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 443 (3<sup>rd</sup> ed. 2015).

<sup>906</sup> A. COLIN CAMERON & PRAVIN K. TRIVEDI, *MICROECONOMETRICS: METHODS AND APPLICATIONS* at 702 (2<sup>nd</sup> ed. 2005); *see also* JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 150 (1<sup>st</sup> ed. 2002).

<sup>907</sup> *Id.* and DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 443 (3<sup>rd</sup> ed. 2015).

<sup>908</sup> HANS-JÜRGEN ANDREß ET AL., *APPLIED PANEL DATA ANALYSIS FOR ECONOMIC AND SOCIAL SURVEYS* at 121 (2013) and MIKE TSIONAS, *PANEL DATA ECONOMETRICS: THEORY* at 363 (2019).

data by 1) failing to control for heterogeneity across countries, because it treats all units as if there are no differences between them and deletes individual unobserved heterogeneities that are relevant to the relationship between the explanatory variables and the outcome variable,<sup>909</sup> and 2) assuming that there is no serial correlation between the observations.<sup>910</sup> This is usually untrue in the case of panel data because an observation of one unit at a given point in time is related to other observations of that unit at other points in time. Therefore, the error terms for the same unit are correlated, which violates the assumption of the model.<sup>911</sup> Pooled ordinary least squares analysis can therefore only be applied to studies in which the differences between samples are unimportant, which is not the case here.

#### 6.1.2.2 Fixed-Effects Model

The fixed-effects model controls for unobserved heterogeneity by assuming that it is correlated with the explanatory variables.<sup>912</sup> In the case of individual-specific unobserved heterogeneity, the model does so by adding a dummy variable  $\alpha_i$  to the regression to represent the individual-specific unobserved heterogeneity, which differs across units but is constant over time and for that unit (i.e., unit-specific time-invariant cofounders). The fixed-effects model treats  $\alpha_i$  as a parameter that should be estimated through the regression equation<sup>913</sup> and assumes

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<sup>909</sup> See MARNÓ VERBEEK, *A GUIDE TO MODERN ECONOMETRICS* at 310 (2000) and BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 13 (3<sup>rd</sup> ed. 2005).

<sup>910</sup> HANS-JÜRGEN ANDREß ET AL., *APPLIED PANEL DATA ANALYSIS FOR ECONOMIC AND SOCIAL SURVEYS* at 123-125 (2013).

<sup>911</sup> Jason W. Osborne, & Elaine Waters, *Four Assumptions of Multiple Regression that Researchers Should Always Test*, 8 *PRACTICAL ASSESSMENT, RESEARCH, AND EVALUATION* 2 (2002).

<sup>912</sup> EDWARD W. FREES, *LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES* at 127 (2004).

<sup>913</sup> HENNING BEST & CHRISTOF WOLF, *THE SAGE HANDBOOK OF REGRESSION ANALYSIS AND CAUSAL INFERENCE* at 334 (2015).

that there is a correlation between it and the observed explanatory variables  $x_i$  (i.e.,  $\text{cov}(x_i, \alpha_i) \neq 0$ ).<sup>914</sup>

An example of individual-specific unobserved heterogeneity in the fixed effects model is the reputation of some GCC countries of being less culturally and religiously constrained, which could influence the effect of regulatory quality (as an explanatory variable) on FDI inflows to these countries.” Reputation can be assumed to be constant (or not to change significantly over the period under observation) for a particular country over time; however, it differs across countries. Therefore, the heterogeneity across units should be controlled for to avoid bias in the estimated parameters.

The regression equation for this model is as follows:

$$y_{it} = \beta_1 x_{1,it} + \dots + \beta_k x_{k,it} + \alpha_i + \varepsilon_{it},$$

where  $y_{it}$  refers to the dependent variable for unit  $i$  at time point  $t$ .  $\beta_1, \dots, \beta_k$  refers to a set of  $K \times 1$  vector parameters that should be estimated,  $x_{1,it}, \dots, x_{k,it}$  refers to a  $1 \times K$  vector of explanatory variables,  $\alpha_i$  refers to an individual-specific effect for which  $\text{cov}(x_i, \alpha_i) \neq 0$ , and  $\varepsilon_{it}$  is the error term.

In the case of time-specific unobserved heterogeneity (time-specific effect), the model controls for the corresponding variable  $\lambda_t$  by accounting for the variation in unobserved factors that occurs at a certain point in time and affects all units.<sup>915</sup> The model assumes that this variation is correlated with the explanatory variables. Examples of the time-specific effect include economic or political incidents that affect all countries in a sample at a particular point in

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<sup>914</sup> JEFFREY M. WOOLDRIDGE, *ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA* at 252 (1<sup>st</sup> ed. 2002).

<sup>915</sup> LÁSZLO MÁTYÁS, *THE ECONOMETRICS OF PANEL DATA: FUNDAMENTALS AND RECENT DEVELOPMENTS IN THEORY AND PRACTICE* at 64 (3<sup>rd</sup> ed. 2008).

time. As an illustrative case, in my sample, the drop in oil prices in 2014 affected all GCC countries at the same time because they all heavily depend on oil as a source of income. This factor is related to the macroeconomic factors (explanatory variables) that are relevant to the study.

When only an individual-specific effect is captured (i.e., by adding  $\alpha_i$ ), the model is called a one-way fixed-effects model.<sup>916</sup> When a time-specific effect variable is added to the regressors  $\lambda_t$ , the model is called a two-way fixed-effects model.<sup>917</sup> This time-specific effect adds another dimension to the regression, accounting not only for individual-specific characteristics, but also for the variation in unobserved factors that occurs at a certain point in time and affects all units.<sup>918</sup> The combined models of individual- and time-specific effects control for unobserved factors that differ across units but are constant over time and also unobserved factors that change over time but are constant over units. The regression equation for this model is as follows:

$$y_{it} = \beta_1 x_{1,it} + \dots + \beta_k x_{k,it} + \alpha_i + \lambda_t + \varepsilon_{it},$$

where  $y$  refers to the dependent variable for unit  $i$  at a given point in time,  $\beta_1, \dots, \beta_k$  refers to a set of  $K \times 1$  vector parameters that should be estimated,  $x_{1,it}, \dots, x_{k,it}$  refers to a  $1 \times K$  vector of explanatory variables,  $\alpha_i$  refers to an individual-specific effect for which  $\text{cov}(xi, \alpha_i) \neq 0$ ,  $\lambda_t$  refers to a time-specific effect for which  $\text{cov}(xi, \lambda_t) \neq 0$ , and  $\varepsilon_{it}$  is the error term.

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<sup>916</sup> A. COLIN CAMERON & PRAVIN K. TRIVEDI, REGRESSION ANALYSIS OF COUNT DATA at 344 (2<sup>nd</sup> ed. 2013).

<sup>917</sup> A. COLIN CAMERON & PRAVIN K. TRIVEDI, REGRESSION ANALYSIS OF COUNT DATA at 365 (2<sup>nd</sup> ed. 2013) and EDWARD W. FREES, LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES at 23 (2004).

<sup>918</sup> EDWARD W. FREES, LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES at 23 (2004) and LÁSZLO MÁTYÁS, THE ECONOMETRICS OF PANEL DATA: FUNDAMENTALS AND RECENT DEVELOPMENTS IN THEORY AND PRACTICE at 64 (3<sup>rd</sup> ed. 2008).

### 6.1.2.3 Random-Effects Model

The random-effects model is another estimation technique for panel data. This model assumes that individual-specific unobserved heterogeneity is a random (as opposed to fixed) variable that is drawn from a larger population.<sup>919</sup> The term  $\alpha_i$  is assumed to be drawn from a normal distribution with a mean of 0 and to be uncorrelated with the explanatory variables.<sup>920</sup> For example,  $\text{cov}(x_i, \alpha_i) = 0$ . Therefore, in the random-effects model, the error term can be conceptualized as a combination of two components, where  $\alpha_i$  represents a country-specific intercept and  $\varepsilon_{it}$  represents everything else.<sup>921</sup>

If a time-specific effect variable is added to the regression, the model is called a two-way random-effects model. In that case, two assumptions are made: that both individual- and time-specific unobserved heterogeneity are random variables that are uncorrelated with the explanatory variables. As an example, a political event, such as a terrorist attack or the Arab Spring, may occur at a specific point of time and affect the whole sample. If the political event is uncorrelated to the explanatory variables and has no effect on FDI for the sample, then it should be controlled for as a time-specific factor that is uncorrelated to the explanatory variables.

The regression equation for this model is as follows:

$$y_{it} = \beta_1 x_{1,it} + \dots + \beta_k x_{k,it} + \alpha_i + \lambda_t + \varepsilon_{it},$$

where  $y_{it}$  refers to the dependent variable for unit  $i$  at a given time point.  $\beta_1, \dots, \beta_k$  refers to a  $K \times 1$  vector of parameters (regression coefficients) that should be estimated,  $x_{1,it}, \dots, x_{k,it}$  refers to a  $1 \times K$  vector of explanatory variables,  $\alpha_i$  refers to an individual-specific effect for which

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<sup>919</sup> CHENG HSIAO, ANALYSIS OF PANEL DATA at 32-33 (1<sup>st</sup> ed. 1986).

<sup>920</sup> EDWARD W. FREES, LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES at 127 (2004).

<sup>921</sup> *Id.* at 73.

$\text{cov}(x_i, \alpha_i) = 0$ ,  $\lambda_t$  refers to time-specific effect for which  $\text{cov}(x_i, \lambda_t) = 0$ , and  $\varepsilon_{it}$  is the error term.

### 6.1.3 *Choosing Between Fixed- and Random-Effects Models*

A researcher, in determining which model to use, should consider the following differences between fixed- and random-effects models.

- 1) When it is assumed that the sample is drawn at random from a larger population and is representative of it,<sup>922</sup> a random-effects model should be used.<sup>923</sup> The inference, in this case, concerns the larger population.<sup>924</sup> However, if the assumption is that the sample contains the entire population and the research focuses on that particular set of units,<sup>925</sup> then a fixed-effects model should be used.<sup>926</sup> The inference, in this case, is conditional on the particular set of units.<sup>927</sup>
- 2) If the individual-specific unobserved characteristics are believed to be uncorrelated with the explanatory variables,<sup>928</sup> then a random-effects model should be used.<sup>929</sup> However, if the individual-specific unobserved characteristics are believed to be correlated with the explanatory variables,<sup>930</sup> then a fixed-effects model should be used.<sup>931</sup>

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<sup>922</sup> EDWARD W. FREES, *LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES* at 127 (2004) and BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 14 (3<sup>rd</sup> ed. 2005).

<sup>923</sup> *Id.*

<sup>924</sup> BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 14 (3<sup>rd</sup> ed. 2005).

<sup>925</sup> EDWARD W. FREES, *LONGITUDINAL AND PANEL DATA: ANALYSIS AND APPLICATIONS IN THE SOCIAL SCIENCES* at 127 (2004).

<sup>926</sup> *Id.*

<sup>927</sup> BADI H. BALTAGI, *ECONOMETRIC ANALYSIS OF PANEL DATA* at 12 (3<sup>rd</sup> ed. 2005)

<sup>928</sup> PAUL D. ALLISON, *FIXED EFFECTS REGRESSION MODELS* at 2-3 (2009).

<sup>929</sup> *Id.* at 2-3.

<sup>930</sup> *Id.* at 3.

<sup>931</sup> *Id.* at 3.

- 3) The fixed-effects model is preferred for balanced panel data.<sup>932</sup> If the panel data is unbalanced, a random-effects model is more appropriate.<sup>933</sup>

The foregoing considerations facilitate the choice between random and fixed effects. In some cases, the choice can be difficult.<sup>934</sup> In such instances, particular statistical tests can be employed to determine which model best fits the panel data.<sup>935</sup> These tests are the Breusch-Pagan Lagrange multiplier (LM) test<sup>936</sup> and the Hausman test.<sup>937</sup> The LM test is useful to choose between pooled ordinary least squares and random effects. If the LM test shows that the random-effects model is superior to pooled ordinary least squares, then the Hausman test can be employed for comparative purposes. The Hausman<sup>938</sup> test facilitates the choice between fixed- and random-effects models. The null hypothesis of the test is that the random effect is consistent.<sup>939</sup> In that case, the  $p$ -value is greater than 0.05. The alternative hypothesis is that the random effect is inconsistent.<sup>940</sup> In that case, the  $p$ -value is below 0.05. Therefore, if the  $p$ -value is greater than 0.05 after the Hausman test has been conducted, the researcher accepts the null hypothesis and uses the random-effects model. However, if the  $p$ -value is less than 0.05, then the null hypothesis is rejected, and the fixed-effects model is more appropriate.

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<sup>932</sup> DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 446 (3<sup>rd</sup> ed. 2015). When data are available for each cross-sectional unit and period, the panel is said to be balanced. See PANCHANAN DAS, *ECONOMETRICS IN THEORY AND PRACTICE* at 460 (1<sup>st</sup> ed. 2019).

<sup>933</sup> DIMITRIOS ASTERIOU & STEPHEN G. HALL, *APPLIED ECONOMETRICS* at 446 (3<sup>rd</sup> ed. 2015).

<sup>934</sup> MARNÓ VERBEEK, *A GUIDE TO MODERN ECONOMETRICS* at 318 (2000).

<sup>935</sup> LÁSZLO MÁTYÁS, *THE ECONOMETRICS OF PANEL DATA: FUNDAMENTALS AND RECENT DEVELOPMENTS IN THEORY AND PRACTICE* at 80–81 (3<sup>rd</sup> ed. 2008).

<sup>936</sup> Trevor S. Breusch & Adrian R. Pagan, *A Simple Test for Heteroscedasticity and Random Coefficient Variation*, 47 *ECONOMETRICA: JOURNAL OF THE ECONOMETRIC SOCIETY* 1287, 1287–1294 (1979).

<sup>937</sup> LÁSZLO MÁTYÁS, *THE ECONOMETRICS OF PANEL DATA: FUNDAMENTALS AND RECENT DEVELOPMENTS IN THEORY AND PRACTICE* at 80–81 (3<sup>rd</sup> ed. 2008).

<sup>938</sup> Jerry A. Hausman, *Specification Tests in Econometrics*, 46 *ECONOMETRICA: JOURNAL OF THE ECONOMETRIC SOCIETY* 1251, 1251–1271 (1978).

<sup>939</sup> MARNÓ VERBEEK, *A GUIDE TO MODERN ECONOMETRICS* at 319 (2000).

<sup>940</sup> *Id.*

## 6.2 RESEARCH DESIGN

The purpose of this research is to determine whether the quality of business-facilitating legal institutions in GCC countries affects FDI inflows to these countries. To achieve this objective, I test the effect of changes in the explanatory variables (including the quality of business-facilitating legal institutions) in each GCC country over a series of time points on FDI inflows to the countries. Panel-data analysis is more suitable than cross-section and time series analyses in this case. A cross-section analysis can analyze GCC countries at one time point, whereas a time series analysis can only analyze one GCC country across multiple time periods. Therefore, panel-data analysis was chosen to study the dynamic relationship between changes in the explanatory variables in the GCC countries over the study period and the outcome variable. The dataset of this study consists of strongly balanced panel data for a sample of six GCC countries. The data cover the period 2008–2017. This period was chosen because data for some GCC countries were unavailable prior to 2008 and after 2017.

The data analysis proceeded in three steps. First, I developed a base model that includes all legal variables that were mentioned in paragraph 6.3.2.1, all macroeconomic variables that were mentioned in paragraph 6.3.2.2, and all political factors that were mentioned in paragraph 6.3.3. I analyzed the base model by using a pooled ordinary-least-squares estimator and a two-way fixed-effects estimator as my main analytical models. There are several reasons for my preference for a two-way fixed-effects model.

- I focus on the special case of the GCC countries, and the results cannot be generalized to countries that do not exhibit similarities to those under observation. In other words, the inference is conditional on similarity—for example, with the same GCC countries in the future. Therefore, it is efficient to use the fixed-effects model because it

assumes that the sample is exhaustive and because the random-effects model is premised on the assumption that the sample is taken from a larger population.

- Although there are similarities between the six GCC countries, these countries differ from each other. Each GCC country has specific characteristics that are correlated with the explanatory variables. I use the fixed-effects model in order to account for the unobserved time-invariant confounders within each country and to avoid bias in the parameters that I estimate.
- I use a two-way fixed-effects model to capture time- and country-specific factors that are correlated with the explanatory variables. Since the GCC countries are located in the same geographic region and depend on oil for their income, factors such as the financial crisis of 2008 and the drop in oil prices in 2014 affected all of the countries at similar points in time. The two-way fixed-effects model enables me to control for these unobserved factors and yields less biased parameter estimates.

The second step of the analysis is to conduct sensitivity analyses in order to assess the robustness of the results from the base model.<sup>941</sup> Ideally, I would compare the results from the base model (in this case, the two-way fixed-effects model) with the result from a two-way random-effects model by conducting a Hausman test. However, random effects cannot be used to analyze the base model. The random-effects model requires that the number of parameters be lower than sample size. Given the size of the sample in this study, which includes six GCC countries, and the 12 parameters of the base-model variables, random effects cannot be

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<sup>941</sup> Because the researcher cannot apply the random effect estimation model to the base-model and compare the fixed effect and random effect results, the researcher will create reduced models. The researcher will analyze these reduced models using fixed effect and random effect estimation models and conduct the Hausman test.

estimated.<sup>942</sup> Therefore, I created reduced models from the base model by decreasing the number of explanatory variables and by changing the nonlegal variables in each such model. I do so in order to test whether changes in the nonlegal variables affect the significance of the legal variables as determinants of FDI. Each reduced model is analyzed through fixed- and random-effects estimators. After analyzing the reduced models in this fashion, I run Hausman tests on them to ascertain whether fixed- or random-effects estimators fit the data better.

The last step of the analysis is to check goodness of fit for the base model and the reduced models (after the Hausman test). The main model of this research is the model with the most satisfactory goodness-of-fit results. To check the goodness of fit of each model, I use the Akaike information criterion (AIC). The AIC is a goodness-of-fit metric that evaluates and compares different models.<sup>943</sup> It compares the number of independent variables in different models and yields maximum likelihood estimates.<sup>944</sup> The model that has the lowest number of parameters and the lowest AIC score fits the data best.<sup>945</sup>

### **6.3 RESEARCH VARIABLES AND DATA**

#### **6.3.1 Outcome Variable**

FDI inflows are the outcome variable of this study. As previously defined, FDI is a long-term cross-border investment whereby a foreign investor assumes control over the management of an enterprise in another economy, with a stake of 10% or more. I measure FDI using total

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<sup>942</sup> The Swamy–Arora two-way random effects model uses two-way ANOVA methods to estimate the random effects. The two-way ANOVA method is constrained by the degree of freedom, which requires the number of sample units (n) or time points (t) to be larger than the number of parameters (k).

<sup>943</sup> SADANORI KONISHI & GENSHIRO KITAGAWA, INFORMATION CRITERIA AND STATISTICAL MODELING at 60-61 (1<sup>st</sup> ed. 2007).

<sup>944</sup> The AIC is calculated by  $-2(\log \text{likelihood}) + 2K$ . K = number of model parameters; log likelihood is a goodness of fit metric. The higher the log likelihood value, the better the fit (taking into account the number of parameters [K]).

<sup>945</sup> See SADANORI KONISHI & GENSHIRO KITAGAWA, INFORMATION CRITERIA AND STATISTICAL MODELING at 60-61 (1<sup>st</sup> ed. 2007).

annual FDI inflows in millions of US dollars (constant relative to 2010) in each of the six GCC countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE—over the period between 2008 and 2017. I calculate the value of FDI inflows on the basis of data from the World Development Indicators (WDI) of the World Bank.

### **6.3.2** *Explanatory Variables*

To examine the relationship between business-facilitating legal institutions in a host country and FDI inflows, I must also consider the nonlegal factors that shape FDI. It is crucial to examine macroeconomic factors when studying the determinants of FDI because FDI is an economic concept. Therefore, I cover two categories of explanatory variables, business-facilitating legal institutions and macroeconomic factors, and I control for political variables.

#### **6.3.2.1 Business-Facilitating Legal Institutions**

The explanatory variables that are the primary focus of this study are those that pertain to business-facilitating legal institutions, which were chosen on the basis of the existing literature. As noted in the literature review, various authors have highlighted the importance of formal institutions and the quality of regulation in host countries for determining the location of FDI and FDI inflows. However, there is no agreement about which laws and regulations are more important for MNEs' location decisions and FDI inflows.<sup>946</sup> Different studies measure the institutional and legal determinants of FDI in different ways. I define the following laws and regulations as variables that are relevant to business-facilitating legal institutions: investment and business laws and regulations, the efficiency of courts, trading across borders, and BITs. I chose those variables for several reasons.

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<sup>946</sup> See *supra* Chapter 3.

- Data for some of the variables that have been demonstrated to be correlated with FDI inflows are unavailable for some countries. For example, I do not include the quality of intellectual property law as a determinant of FDI because of the unavailability of data for the GCC countries.<sup>947</sup>
- I only include factors that are relevant to business-facilitating laws and regulation. Previous contributions refer to “institutions” without differentiating between political and legal factors.<sup>948</sup> As my main interest is legal variables, I do not measure any variables that have a political dimension. Instead, I control for political factors by subsuming them into a separate category called “political variables.” Some studies include nonlegal factors, such as the ease of obtaining electricity or that of acquiring construction permits, as factors when analyzing the business environments of host countries. However, as these variables are not strictly legal, they are not included in my analysis.
- I eliminate legal variables that overlap. For example, in previous studies, the amount of time that is needed to start a business has been shown correlate with FDI inflows. However, this time indicator is also captured by “regulatory quality.” Therefore, this

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<sup>947</sup> See Jeong-Yeon Lee & Edwin Mansfield, *Intellectual Property Protection and US Foreign Direct Investment*, 78 THE REVIEW OF ECONOMICS AND STATISTICS 181, 181–186 (1996) and Keith E. Maskus, *Intellectual Property Rights and Foreign Direct Investment* (Centre for International Economic Studies, Working Paper No. 22, 2000) and Beata Smarzynska Javorcik, *The Composition of Foreign Direct Investment and Protection of Intellectual Property Rights: Evidence from Transition Economies*, 48 EUROPEAN ECONOMIC REVIEW 39, 39-62 (2004) and Judy Hsu & Yu-En Tiao, *Patent Rights Protection and Foreign Direct Investment in Asian Countries*, 44 ECONOMIC MODELLING 1, 1–6 (2015) and Belay Seyoum, *The Impact of Intellectual Property Rights on Foreign Direct Investment*, 31 THE COLUMBIA JOURNAL OF WORLD BUSINESS 50, 50–59 (1996) and Thierry Mayer & Etienne Pfister, *Do Stronger Patent Rights Attract Foreign Direct Investment? Evidence from French Multinationals’ Location*, 13 RÉGION ET DÉVELOPPEMENT 99, 99–122 (2001) and James Mitchell Watkins & Mark Zachary Taylor, *Intellectual Property Protection and US Foreign Direct Investment in Emerging Economies*, 15 JOURNAL OF INTELLECTUAL PROPERTY RIGHTS, 415, 415-428 (2010) and Dimitrios Kyrkilis & Sofia Koboti, *Intellectual Property Rights as Determinant of Foreign Direct Investment Entry Mode: The Case of Greece*, 19 PROCEDIA ECONOMICS AND FINANCE 3, 3–16 (2015).

<sup>948</sup> See *supra* Chapter 3.

study does not employ “start business” as a separate variable; it is analyzed as an element of regulatory quality.

### **Business-Facilitating Legal Institutions: Description of Data and Sources**

As mentioned above, this dissertation assesses business-facilitating legal institutions by using the following variables: investment and business laws and regulations, court efficiency, trading across borders, and BITs. In the following pages, I describe each variable, its importance as a determinant of FDI, its measurement, and its sources.

First, I use indicators of “regulatory quality” from the Worldwide Governance Indicators (WGI)<sup>949</sup> to capture the effectiveness of local investment and business laws. The WGI dataset defines this indicator as “the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.”<sup>950</sup> It captures the following business law-related matters: investment laws, the ease of starting a business, discriminatory tariffs and taxes, the burden of government regulation, the prevalence of non-tariff barriers, regulatory burdens, and the risk of business operations becoming more costly because of regulation. The WGI project collects data to measure this indicator through surveys completed by public- and private-sector experts.<sup>951</sup> I expect to identify a positive relationship between regulatory quality and FDI inflows. This expectation is premised on the proposition that unsound regulations and policies in a host country increase transaction costs and thereby discourage investment.

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<sup>949</sup> The Worldwide Governance Indicators is a World Bank project that evaluates governance quality for more than 200 countries based on six indicators: voice and accountability, political stability and the absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption. See Daniel Kaufmann et al., *The Worldwide Governance Indicators: Methodology and Analytical Issues*, 3 HAGUE JOURNAL ON THE RULE OF LAW 220, 220–246 (2011).

<sup>950</sup> Daniel Kaufmann et al., *The Worldwide Governance Indicators: Methodology and Analytical Issues*, 3 HAGUE JOURNAL ON THE RULE OF LAW 220, 220–246 (2011).

<sup>951</sup> *Id.*

Second, I use the quality of courts in a host country as a legal determinant of FDI. A transparent, predictable, and efficient court system is favorable for MNEs that operate abroad. Many international businesses prefer arbitration over litigation before host-country courts. This is particularly true in developing countries because of problems such as time-consuming procedures, biases against foreigners, and inconsistent rulings. Therefore, the quality of the court system is an important factor for analysis of the legal determinants of FDI. This dissertation specifically uses “enforcement contracts” from the EDB index<sup>952</sup> as a proxy for the quality of the host-country courts. The EDB index measures the enforcement of contracts on the basis of the related procedures as well as the time and costs that are associated with debt enforcement. The EDB initiative analyzes codes of civil procedure and other court regulations and collects questionnaires completed by local litigators and judges. The evaluation of the ease of enforcing a contract in a country reflects the results of a hypothetical commercial dispute between a seller and a buyer. The countries are evaluated on the basis of three sub-indicators, namely time, cost, and enforcement. The EDB index measures the time that must pass for a case to be filed, for a trial to be held and judgment rendered, and for that judgment to be enforced. To determine cost, the EDB index measures attorney fees, court fees, and enforcement fees. The index measures the quality of the judicial process by reference to four factors: court structure and proceedings, case management, court automation, and alternative dispute resolution.<sup>953</sup> A score is then assigned to each country for the ease with which contracts can be enforced. The scores is based on the

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<sup>952</sup> Doing Business is one of the World Bank’s projects. It aims to measure the business regulations and their enforcement. The project was launched in 2002. This project, the Doing Business, tests countries’ business regulations and their enforcement in 10 subindices. These subindices are: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency.

<sup>953</sup> For more information about the methodology and data collection, see Subnational Studies Measuring Business Regulation, Doing Business, <https://subnational.doingbusiness.org/en/data/exploretopics/enforcing-contracts/what-measured> (last visited Mar. 15, 2022).

average scores on each of the three sub-indicators. I expect to identify a positive relationship between the enforcement of contracts and FDI inflows.

Third, I use the “trading across borders” indicator from the EDB index. This indicator is important for analysis of the quality of business-facilitating institutions because less restrictive trade regulations reduce the cost of export-seeking FDI and the cost of imports, which is relevant to market-seeking FDI.<sup>954</sup> The EDB initiative collects data by analyzing responses to questionnaires that are sent to local freight forwarders, customs brokers, port authorities, and traders.<sup>955</sup> It measures the ease of trading across borders by reference to the number of documents, cost, and time that is necessary to export and import goods.<sup>956</sup> I expect to identify a positive relationship between trading across borders and FDI inflows.

The fourth legal factor that affects FDI inflows has to do with IIAs. As explained in Chapter 4, IIAs encourage investment by offering protection to investors from signatory states. Therefore, the effectiveness of such agreements is an important legal determinant of FDI.

As noted in Chapter 4, there are many types of IIAs. The most important are BITs, RIAs, FTAs with investment-related provisions, and investment-related multilateral agreements. In this study, I only examine the correlation between BITs in the GCC countries and FDI inflows because there is almost no difference between the number of other IIAs across the GCC countries.<sup>957</sup> Using information from the Investment Policy Hub of the UNCTAD,<sup>958</sup> I calculate the number of BITs that were in force in each year of the observation period, and I subtract the

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<sup>954</sup> See *supra* Chapter 2.

<sup>955</sup> Methodology, Doing Business, <https://www.doingbusiness.org/en/methodology> (last visited Mar. 15, 2021); see also Subnational Studies Measuring Business Regulation, Doing Business, <https://subnational.doingbusiness.org/en/data/exploretopics/trading-across-borders/what-measured> (last visited Mar. 15, 2022).

<sup>956</sup> *Id.*

<sup>957</sup> See *supra* Chapter 3.

<sup>958</sup> Investment Policy Hub, United Nations UNCTAD, <https://investmentpolicy.unctad.org> (last visited Mar. 15, 2021).

number of BITs that were terminated in that year from this sum. I expect to identify a positive correlation between the number of BITs that are in force and FDI inflows.

Table 6.1 below presents a summary of the business-facilitating legal variables, their measurement, and their sources.

**Table 6.1** *Summary of the business-facilitating legal variables, measurement, and the sources*

Variable	Measurement	Source	Hypothesis
Regulatory quality	The ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development	Worldwide Governance Indicators	+
Enforcing contracts	Procedures, time, and cost of enforcing a debt contract	Doing Business	+
Trading across borders	Number of documents, cost, and time necessary to export and import	Doing Business	+
Bilateral investment treaties (BITs)	The cumulative number of BITs that were in force each year less BITs that were terminated in the same year	Calculated by the author on the basis of data from the Investment Policy Hub of UNCTAD	+

### 6.3.2.2 Macroeconomic Factors

The second category of explanatory variables is macroeconomic indicators. As noted in the literature review, many empirical studies report on the correlation between macroeconomic factors and FDI inflows. The macroeconomic factors in question include market size, GDP growth, and inflation.

- **Market size.** Large markets are associated with high purchasing power. As a result, larger markets are expected to receive more FDI than smaller markets due to higher

domestic demand. Thus, a positive relationship between market size and FDI is expected. I use GDP per capita and population as proxies for market size. GDP per capita is measured by the GDP in constant 2010 US dollars divided by population size. Population, as a proxy for market size, is measured as the number of all of the residents of a country, including both citizens and non-citizens. The data for both GDP per capita and population are sourced from the WDI of the World Bank.

- **GDP growth.** GDP growth is defined as the percentage change in GDP. The importance of GDP growth as a determinant of FDI stems from the manner in which GDP growth predicts the potential of a market.<sup>959</sup> Market-seeking foreign investors are interested not only in large markets but also in rapid growth.<sup>960</sup> In this study, the measure of annual GDP growth is based on changes in market prices, assuming that the value of the local currency is consistent. I expect the relationship between GDP growth and FDI to be positive. The data for this variable are sourced from the WDI of the World Bank.
- **Inflation rate.** In this study, the inflation rate is measured by the annual growth rate of the GDP implicit deflator, which shows the rate of change in prices across the economy. High inflation rates can be indicative of macroeconomic instability, which discourages FDI inflows. Conversely, low inflation can be indicative of macroeconomic stability. Therefore, a negative relationship is expected between inflation and FDI inflows. The inflation data are sourced from the WDI of the World Bank.

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<sup>959</sup> Muhammad Tariq Majeed & Eatnaz Ahmad, *FDI and Exports in Developing Countries: Theory and Evidence*, 46 THE PAKISTAN DEVELOPMENT REVIEW 735, 735–750 (2007).

<sup>960</sup> Friedrich Schneider & Bruno S. Frey, *Economic and Political Determinants of Foreign Direct Investment*, 13 WORLD DEVELOPMENT 161, 161–175 (1985).

Table 6.2 presents a summary of the macroeconomic variables, their definitions, and their sources.

**Table 6.2** *Summary of the macroeconomic variables, definitions, and sources*

<b>Macroeconomic variables</b>	<b>Measurement</b>	<b>Source</b>	<b>Hypothesis</b>
<b>Market size</b>	GDP per capita: GDP in constant 2010 US dollars divided by population Population: <i>de facto</i> population, counting all residents of the country (both citizens and non-citizens)	World Development Indicators	+
<b>GDP growth</b>	Changes in market prices, assuming consistent value of the local currency	World Development Indicators	+
<b>Inflation rate</b>	The annual growth rate of the GDP implicit deflator	World Development Indicators	-

### 6.3.3 *Control Variables*

Aside from business-facilitating legal institutions and macroeconomic indicators, a third category of factors—political factors—can also play a role in the location decisions of MNEs and FDI inflows. According to the literature, the primary political factors that play a role in FDI inflows are political stability, control over corruption, and property rights (expropriation).

Because they are not the focus of the research, these variables are treated as control variables.

Table 6.3 below presents the variables, their definitions, and their sources.

**Table 6.3** *Summary of the political institution variables, definitions, and sources*

<b>Control Variables</b>	<b>Definition</b>	<b>Source</b>
Political stability	Political stability and the absence of violence or terrorism are indicative of the likelihood of political instability, including terrorism and business losses	Worldwide Governance Indicators
Control over corruption	The extent to which public power is exercised for private gain	Worldwide Governance Indicators
Property rights	The extent to which property rights, including financial assets, are protected	The Global Competitiveness Report

The substantive hypotheses that were presented in this section are as follows:

H1: Regulatory quality has a positive effect on FDI inflows to the GCC countries.

H2: Enforcing contracts has a positive effect on FDI inflows to the GCC countries.

H3: Trading across borders has a positive effect on FDI inflows to the GCC countries.

H4: The number of BITs has a positive effect on FDI inflows to the GCC countries.

H5: GDP per capita has a positive effect on FDI inflows to the GCC countries.

H6: Population has a positive effect on FDI inflows to the GCC countries.

H7: GDP growth has a positive effect on FDI inflows to the GCC countries.

H8: The inflation rate has a negative effect on FDI inflows to the GCC countries.

#### **6.4 DESCRIPTIVE STATISTICS**

Table 6.4 displays the descriptive statistics for the dependent and independent variables. It presents the means, medians, interquartile ranges (IQR), variances (Var), standard deviations (SD), and minimum and maximum values.

**Table 6.4** *Descriptive statistics for the dependent and independent variables*

	<b>Mean</b>	<b>Median</b>	<b>IQR</b>	<b>Var</b>	<b>SD</b>	<b>Minimum</b>	<b>Maximum</b>
<b>FDI</b>	5,044.023	1,403.359	6,231.678	71,792,874	8,473.068	-1838.746	40,488.384
<b>Regulatory quality</b>	65.88142	67.78048	17.59878	88.30512	9.397081	48.55769	82.69231
<b>Enforcing contracts</b>	54.23697	52.32965	4.54323	22.88166	4.783478	50.06559	75.87629
<b>Trading across borders</b>	74.38183	75.21918	5.19512	89.75742	9.474039	48.45177	91.58968
<b>BITs</b>	30.31667	25.5	12.5	208.6268	14.44392	13	68
<b>Population</b>	8,156,941	3,512,202	6,854,226	1.001245e+14	10,006,225	1,114,641	33,099,147
<b>GDP per capita</b>	33,696.2	27,897.58	19,817.82	287,646,138	16,960.13	15,630.49	69,679.09
<b>GDP growth</b>	4.047387	3.895294	3.087952	20.84981	4.566159	-7.076056	19.592332
<b>Inflation rate</b>	1.625916	2.05548	17.94671	175.764	13.2576	-25.95842	33.75154

#### 6.4.1 *Outcome Variable*

The descriptive statistics show that the average value of FDI inflows to the GCC countries was \$5,044,023,000 annually. The lowest value of FDI inflows in the sample is - \$1,838,746,000 (Oman in 2015), followed by -\$786,600,000 (Qatar in 2013) and -\$6,107,504 (Kuwait in 2008). These negative values indicate that FDI flowed out of the countries in question. The three values are the only negative values in the data. The maximum value of FDI inflows in the dataset is \$40,488,384,000 (Saudi Arabia in 2008).

The SD of the dependent variable is \$8,473,068,000. Therefore, FDI inflows to the GCC countries typically differed from the average (the mean) by \$8,473,068,000. The distribution is skewed to the right because the median—\$1,403,359,000—is lower than the mean. Therefore, the countries that received low FDI inflows (the left tail) are more numerous than the countries that received high FDI inflows (the right tail).

## 6.4.2

### *Explanatory Variables*

#### 6.4.2.1 Business-Facilitating Legal Institutions

##### **Regulatory quality**

The WGI scores countries on a scale of 0 to 100, where 0 denotes the lowest regulatory quality and 100 denotes the highest regulatory quality. The descriptive statistics indicate that the average regulatory quality score among the GCC countries over the study period was 65.88142. The lowest score was 48.55769 for Kuwait in 2015, and the highest was 82.69231 for the UAE in 2015. The distribution is skewed to the left because the median—67.78048—is greater than the mean. In other words, there are fewer countries with low regulatory quality in the sample than countries with high regulatory quality. The SD is 9.397081. Therefore, the regulatory quality scores of the GCC countries typically differed from the average by 9.397081.

##### **Enforcing contracts**

The EDB index rates countries on a scale from 0 to 100. The higher the score, the better the state apparatus of a country performs when a contract has to be enforced. On average, the GCC countries obtained a score of 54.23697. The minimum of 50.06559 was recorded for Oman in 2008, whereas the maximum of 75.87629 was recorded for the UAE in 2017. The distribution is skewed to the right because the median of 52.32965 is lower than the mean. The SD is 4.783478.

##### **Trading across borders**

The EDB index rates countries for the ease with which one can trade across borders, on a scale from 0 to 100. The highest score, indicating the greatest ease, is 100. The average score that the GCC countries received was 74.38183. The lowest score in the sample is 48.45177,

received by Saudi Arabia in 2017. The UAE obtained the highest score in the sample, 91.58968, in 2014. The SD is 9.474039. The distribution is skewed to the left because the mean is lower than the median.

### **BITs**

The average number of BITs that were ratified in the GCC countries was 30.31667. The minimum value is 13, and the maximum is 68. The distribution is skewed to the right because the median, 25.5, is lower than the mean. The SD is 14.44392. Therefore, the number of BITs that were ratified in the GCC countries typically differs from the average (mean) by 14.44392.

#### **6.4.2.2 Macroeconomic Factors**

The descriptive statistics reveal that the average population of the GCC countries was 8,156,941 between 2007 and 2018. The minimum value is 1,114,641, and the maximum is 33,099,147. The data are skewed to the right because the median of 3,512,202 is lower than the mean. Therefore, in the GCC, there are more countries with populations below the mean than countries with populations above the mean. The SD is 10,006,225. Therefore, the population of GCC countries typically differs from the average (the mean) by 10,006,225.

Table 6.4 illustrates that the average GDP per capita in the GCC countries was \$33,696.20 between 2007 and 2018. The distribution is skewed to the right because the median of \$27,897.58 is lower than the mean. Therefore, in the GCC, there are more countries with a GDP per capita below the mean than countries with a GDP per capita above the mean. The SD is \$16,960.13. Therefore, GDP per capita in the GCC countries typically differs from the average by \$16,960.13. Furthermore, the GCC countries exhibited an average GDP growth of 4.047387. The minimum is -7.076056, and the maximum is 19.592332. The SD is 4.566159. The mean inflation rate is 1.625916, with a minimum of -25.95842 and a maximum of 33.75154. The SD is

13.2576. The data for GDP per capita, GDP growth, and inflation rate are skewed to the right—the mean values are larger than the median values.

## 6.5 ESTIMATION MODELS

This section is divided into two parts. The first subsection presents the analysis of the base model, including all legal, macroeconomic, and political variables. The second subsection presents the reduced models and sensitivity tests.

### 6.5.1 *Base Model*

The base model in this research includes all of the legal, macroeconomic, and political variables that were described in Subsections 6.3.2 and 6.3.3. These variables are regulatory quality, BITs, trade across borders, enforcing contracts, GDP per capita, population, GDP growth, and inflation. I also control for the following political variables: political stability, control over corruption, and property rights. The following paragraphs discuss the pooled ordinary least squares model and the two-way fixed-effects estimation models.

#### 6.5.1.1 Pooled Ordinary Least Square

This study estimates the following model for pooled ordinary least squares:

$$FDI_{it} = \beta_0 + \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \varepsilon_{it}, \quad (1)$$

where FDI is the outcome variable,  $i = 1, \dots, 6$  denotes the six GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE), and  $t = 2008, \dots, 2017$  captures the period under observation.  $\beta_0$  is the intercept,  $\beta$  denotes the coefficients for the macroeconomic factors,  $\gamma$  denotes the coefficients for the legal factors,  $\psi$  denotes the coefficients for the political factors,  $X$  denotes legal factors,  $Y$  denotes macroeconomic factors,  $Z$  denotes political factors, and  $\varepsilon_{it}$  is the

error term. Logs are taken for two of the macroeconomic variables, GDP per capita and population, to normalize the distribution by reducing skew produced by extreme values.

### 6.5.1.2 Two-Way Fixed Effects

This study uses a two-way fixed-effects model to adjust for unobserved country- and time-specific confounders. The model for this approach is as follows:

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (2)$$

where  $\alpha_i$  captures the country-specific effect and  $\lambda_t$  captures year-specific effects. The other elements of the equation represent the same variables as in Equation (1).

### 6.5.2 *Reduced Model and Sensitivity Test*

The preferred method of identifying the estimation model that best fits the data would entail comparing the fixed-effects estimation model (Equation 2) with the random-effects estimation model and using the Hausman test to choose the superior estimator. However, due to the size of the sample, I cannot use the random-effects estimation model.<sup>961</sup> Therefore, I draw on reduced models that include fewer parameters (four variables). I create four models that include the key legal variables of interest (regulatory quality and BITs), with variations in macroeconomic variables and controls for political stability.<sup>962</sup> The variables in each reduced model are as follows:

- Model 1—regulatory quality, BITs, GDP per capita, and political stability

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<sup>961</sup> See *supra* note 944.

<sup>962</sup> The reason for choosing political stability from other political factors is that based on the base-model and FDI literature, political stability is considered the most significant. See SOPHIA QASRAWI, FOREIGN DIRECT INVESTMENT IN THE UAE: DETERMINANTS AND RECOMMENDATIONS (1<sup>st</sup> ed. 2004) and Mohamed Mahjoub Elheddad, *Natural Resources and FDI in GCC Countries*, 6 INTERNATIONAL JOURNAL OF BUSINESS AND SOCIAL RESEARCH 12, 12–22 (2016).

- Model 2—regulatory quality, BITs, population, and political stability
- Model 3—regulatory quality, BITs, growth, and political stability
- Model 4—regulatory quality, BITs, inflation, and political stability

The four reduced models are analyzed by using two panel-data model estimators, the fixed-effects model and the random-effects model. There are thus eight regressions. After running the regressions, I conduct a Hausman test to assess whether fixed effects or random effects better fit the data. Finally, to assess goodness of fit, I compare the AIC scores of all the models.

The following paragraphs address the fixed- and random-effects estimators of the four reduced models.

### 6.5.2.1 Two-Way Fixed Effects

The following equations capture the four two-way fixed-effects models:

#### Model 1

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (3)$$

#### Model 2

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (5)$$

#### Model 3

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (7)$$

#### Model 4

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (9)$$

where FDI is the dependent variable,  $i = 1, \dots, 6$  denotes the six GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE), and  $t = 2008, \dots, 2017$  indicates the period

under observation.  $\beta$  denotes the coefficients of the macroeconomic factors,  $\gamma$  denotes the coefficients of the legal factors,  $\psi$  denotes the coefficients of the political factors,  $X$  denotes legal factors (as described in Subsection 6.5.2),  $Y$  denotes macroeconomic factors (as described in Subsection 6.5.2),  $Z$  denotes political factors (as described in Subsection 6.5.2),  $\alpha_i$  captures the country-specific effect for which  $\text{cov}(xi, \alpha_i) \neq 0$ ,  $\lambda_t$  refers to the time-specific effect for which  $\text{cov}(xi, \alpha_i) \neq 0$ , and  $\varepsilon_{it}$  is the error term.

### 6.5.2.2 Two-Way Random Effects

The following equations capture the four two-way random-effects models:

#### Model 1

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (4)$$

#### Model 2

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (6)$$

#### Model 3

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (8)$$

#### Model 4

$$FDI_{it} = \beta X_{it} + \gamma Y_{it} + \psi Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it}, \quad (10)$$

where  $\alpha_i$  refers to the country-specific effect for which  $\text{cov}(xi, \alpha_i) = 0$ , and  $\lambda_t$  refers to the time-specific effect for which  $\text{cov}(xi, \alpha_i) = 0$ . The other elements of the equation represent the variables that were described in paragraph 6.5.2.1.

## 6.6 REGRESSION RESULTS

### 6.6.1 *Base Model Results*

Table 6.5 presents the results for the coefficients of the explanatory variables from the base model. Only business-facilitating legal institution variables and macroeconomic variables are presented because the study does not focus on political variables.

**Table 6.5** *Base model results*

Variables		Pooled OLS (1)	Fixed Effect (2)
Business-facilitating legal institutions	Regulatory quality	-132.635 (196.553)	721.113*** (167.207)
	BITs	-178.283 (125.352)	263.370* (99.240)
	Trading across borders	333.973*** (79.388)	540.725** (127.868)
	Enforcing contracts	247.590 (160.630)	229.610 (128.869)
Macroeconomic factors	GDP per capita	4,277.428** (1,254.251)	-11697.701 (6,819.265)
	Population	4,324.433*** (735.792)	39,695.530** (14,368.703)
	Growth	230.228** (65.922)	458.804*** (120.631)
	Inflation	47.164 (85.107)	149.313 (120.998)
# observations		60	60
AIC		1,229.56	1,148.409

\* $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . Driscoll and Kraay's SEs are reported in parentheses.

First, the results from the pooled ordinary least squares model indicate that GDP per capita, population, and growth have positive and statistically significant correlations with FDI

inflows. Three of the legal variables have an effect on FDI. However, the pooled ordinary least squares model is not reliable in this case because it does not account for country- and year-specific confounders.

The results from the second model, the two-way fixed-effects model, show that three of the four legal factors have significant positive effects on FDI, and one variable has an insignificant positive effect on FDI inflows to the GCC countries.<sup>963</sup> A one-point increase in regulatory quality causes an increase in FDI inflows of \$721.113 million on average, and entry into an additional BIT causes an average increase of \$263.370 million. Meanwhile, a one-point increase in the trading across borders variable is associated with an increase in FDI inflows of \$540.725 million on average. Finally, the enforcing contracts variable has a positive but insignificant correlation with FDI inflows to the GCC countries.

The results demonstrate that, among the macroeconomic variables, only the GDP growth rate and population are significantly correlated with FDI inflows. GDP growth has a positive coefficient of 458.804. Population also has a strong positive relationship with FDI inflows. A one-unit change in population produces, on average, a \$39,695.530 million increase in FDI inflows. The other two macroeconomic variables, GDP per capita and inflation, have no significant correlations with FDI inflows to the GCC countries.

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<sup>963</sup> The UAE data is excluded from the dataset when running sensitivity tests to check the robustness of the results for the business-facilitating legal institution variables. The outcomes of trading across the border and enforcing contracts persist almost the same as in the base model. The coefficient for regulatory quality remains positive but becomes weaker. The coefficient for BITs becomes weaker. These results could indicate that the significance of regulatory quality and BITs in the base model could be driven mainly by the variation in the regulatory quality and BITs in the UAE. Further investigations should be performed to check whether the results are caused only by the UAE, providing an area for future research.

## 6.6.2

### *Results from Reduced Models*

Table 6.6 below presents the results for the coefficients of the explanatory variables in the four reduced models.

**Table 6.6** *Reduced models result*

Variables	Reduced Model 1		Reduced Model 2		Reduced Model 3		Reduced Model 4	
	Fixed Effect (3)	Random Effect (4)	Fixed Effect (5)	Random Effect (6)	Fixed Effect (7)	Random Effect (8)	Fixed Effect (9)	Random Effect (10)
Regulatory quality	640.480** (222.576)	137.62 (135.33)	630.03** (214.10)	-35.321 (91.932)	420.99* (175.34)	20.534 (103.597)	437.083* (185.937)	106.817 (91.594)
BITs	264.740 (80.285)**	-239.69 (203.14)	490.47*** (104.26)	-192.853 (139.067)	252.23 (132.26)	-217.964 (207.886)	312.688** (109.312)	-224.432 (223.380)
GDP per capita	-41445.150*** (10,400.781)	-10741 (6,233.4)						
Population			47,573.94*** (6,315.08)	4,284.971* (1920.673)				
Growth					181.02 (131.95)	309.937** (113.562)		
Inflation							-22.107 (143.295)	57.724 (48.947)
# observations	60	60	60	60	60	60	60	60
Hausman test	0		0		0.0019		0.0012	
AIC	1,183.124	-	1181.906	-	1197.406	-	1198.21	-

\* $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . Driscoll and Kraay's SEs are reported in parentheses.

After running the regressions for the four reduced models, I use the Hausman test to compare the results from the random-effects model to those from the fixed-effects model. The  $p$ -values in the four models are below 0.05. Therefore, the fixed-effects models better fit the data than the random-effects models. The goodness-of-fit test of the four fixed-effects models yields the lowest value for Model 2 (Equation 5). Therefore, the strongest of the four reduced models includes the variables regulatory quality, BITs, population, and political stability. In this model, the legal variables regulatory quality and BITs have significant positive effects on FDI inflows to the GCC countries. Regulatory quality has a coefficient of 630.03, which indicates that a one-point increase in regulatory quality causes an increase in FDI inflows of \$630.03 million. The number of BITs has a coefficient of 490.47. Thus, a one-point increase in BITs causes an increase in FDI inflows of \$490.47 million. The results also reveal that population has a significant positive correlation with FDI inflows, with a coefficient of 47,573.94.

However, the comparison of the AIC values from the reduced models with the AIC value from the base model indicates that the latter has the lowest AIC, at 1,148.409. The base model best fits the data.

The findings may be summarized as follows. First, the determinants of FDI in the GCC countries include regulatory quality, the number of BITs, trade across borders, growth, population, political stability, and control over corruption. Second, business-facilitating legal institutions—specifically those that are relevant to regulatory quality, the number of BITs, and trade across borders—play a significant role in attracting FDI inflows to the GCC countries. Gains in regulatory quality, the number of BITs, and the efficiency of cross-border trade increase FDI inflows.

## 6.7 DISCUSSION

As noted in the theoretical framework of this dissertation, according to Dunning's OLI paradigm,<sup>964</sup> MNEs must adopt a three-tiered approach to deciding whether to invest in a foreign country. These tiers are ownership advantage,<sup>965</sup> location advantage,<sup>966</sup> and internalization.<sup>967</sup> This dissertation concerns the second tier of the paradigm, location advantage, which makes one location more attractive for FDI than others.<sup>968</sup> Location advantage acts as a determinant of FDI and can refer to various factors, including economic and institutional factors. Dunning noted that "MNEs are increasingly seeking locations which offer the best economic and institutional facilities for their core competencies to be efficiently utilized."<sup>969</sup>

Institutions are defined as "the rules of the game in a society."<sup>970</sup> They are "cognitive, normative, and regulative structures and activities that provide stability and meaning to social behavior."<sup>971</sup> Institutions can be formal, such as laws and regulations, or informal, such as morality, values, culture, and beliefs.<sup>972</sup> This research examines formal institutions as a basis for location advantage and as a determinant of FDI. I specifically examined business-facilitating legal institutions—that is, the rules of the game that facilitate the operation of business and business transactions in a given country. In this study, the term "business-facilitating legal

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<sup>964</sup> JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 116–143 (2<sup>nd</sup> ed. 2008) and John H. Dunning, *The Eclectic (OLI) Paradigm of International Production: Past, Present and Future*, 8 *INTERNATIONAL JOURNAL OF THE ECONOMICS OF BUSINESS* 173, 173–190 (2001).

<sup>965</sup> *Id.*

<sup>966</sup> *Id.*

<sup>967</sup> *Id.*

<sup>968</sup> JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 128–129 (2<sup>nd</sup> ed. 2008).

<sup>969</sup> John H. Dunning, *Location and the Multinational Enterprise: A Neglected Factor?*, 29 *JOURNAL OF INTERNATIONAL BUSINESS STUDIES* 45, 45–66 (1998).

<sup>970</sup> DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE* at 3 (1990).

<sup>971</sup> W. RICHARD. SCOTT, *INSTITUTIONS AND ORGANIZATIONS* at 33 (1<sup>st</sup> ed. 1995).

<sup>972</sup> CONSTANZE DOBLER, *THE IMPACT OF FORMAL AND INFORMAL INSTITUTIONS ON ECONOMIC GROWTH A CASE STUDY ON THE MENA REGION* at 14 (2011).

institutions” is used to refer only to legal factors and excludes any political factors that are associated with the term “institution” in the literature. Instead, the political factors in question are aggregated into a separate category called “political institutions.”

Institutions are important for the location decisions of MNEs because they reduce transaction costs.<sup>973</sup> Poor institutions increase transaction costs—both directly, by creating inefficiencies that result in the dissipation of time and capital (discriminatory taxes and tariffs for foreign investors are salient examples) and indirectly, as in cases when transaction costs increase due to uncertainty. For example, ambiguous legal rules increase transaction costs because they require companies to retain lawyers who can clarify the rules when necessary. It is not feasible for MNEs to invest abroad if the host country institutions are poor and entail high transaction costs. Such rules put foreign investors at a disadvantage when they compete against domestic investors.

Business-facilitating legal institutions only partially determine FDI inflows to the GCC countries. As highlighted in Chapter 3, the literature has not identified determinants of FDI that are relevant to all countries. There are two reasons for this failure. First, incentives and motivations for attracting FDI differ across countries.<sup>974</sup> Some countries offer more incentives to MNEs and remove a higher number of tariff and non-tariff barriers than others because their demand for FDI is higher. Second, the incentives of MNEs to invest in foreign countries vary with investment types. For example, an MNE that intends to manufacture products seeks host

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<sup>973</sup> JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 125-128 (2<sup>nd</sup> ed. 2008); *see also* DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE* (1990).

<sup>974</sup> *See* ARISTIDIS BITZENIS ET AL., *MERGERS AND ACQUISITIONS AS THE PILLAR OF FOREIGN DIRECT INVESTMENT* at 62 (2012).

countries with low labor costs.<sup>975</sup> Market-seeking investors, in contrast, seek out countries with large markets.<sup>976</sup> Therefore, the determinants of FDI differ across countries and MNEs. Thus, as emphasized in Chapter 3, the best way to identify the determinants of FDI is to run empirical tests on specific groups of countries that share certain characteristics, such as natural resource endowments, economic attributes, and culture.

In identifying the determinants of FDI inflows to the GCC countries, I chose the variables that are predicted to have the strongest effect on FDI inflows.<sup>977</sup> I categorized those variables into three types: business-facilitating legal institution variables, macroeconomic variables, and political variables. The business-facilitating legal institution variables are regulatory quality, contract enforcement, trading across borders, and the number of BITs. The macroeconomic variables are market size (measured by reference to GDP per capita and population), GDP growth, and inflation rate. Lastly, I controlled for the political variables political stability, control over corruption, and property rights protection.

The following subsections discuss the results. The first subsection discusses business-facilitating legal institutions, and the second discusses the macroeconomic variables.

### **6.7.1 *Business-Facilitating Legal Institution Variables***

The regression of the business-facilitating legal institution variables yielded several results. First, in line with H1, the results showed that regulatory quality has a significant positive association with FDI inflows to the GCC countries. This result is in line with the findings of

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<sup>975</sup> See JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 72 (2<sup>nd</sup> ed. 2008).

<sup>976</sup> See JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 69–71 (2<sup>nd</sup> ed. 2008).

<sup>977</sup> I was also restricted by the number of variables since the analysis model does not allow variables more than the sample size (N), see Chapter 6.

Sabir et al. (2019),<sup>978</sup> who found a positive and significant effect of regulatory quality on FDI to developed countries, and with the findings of Bissoon (2012),<sup>979</sup> who focused on 45 developing countries in Africa, Latin America, and Asia. However, my results contradict the findings of Mengistu and Adhikary (2011),<sup>980</sup> who found an insignificant correlation between regulatory quality and FDI inflows to Asian countries.

As mentioned in 6.3.2.1, the regulatory quality variable measures the effectiveness of local laws that are related to investment and business. The WGI project defines this indicator as “the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.”<sup>981</sup> The regulatory quality variable captures policies and regulations such as discriminatory tariffs, discriminatory taxes, the burden of government regulation, and tax inconsistency. It also reflects investor freedom and the procedures for starting a business or a subsidiary. Unsound regulations and policies in the host country increase transaction costs and the cost of doing business, thereby discouraging investment. Masron and Abdullah (2010) concluded that “[i]nstitutional quality could also serve as the cost of doing business.”<sup>982</sup> Therefore, it is essential that countries adopt sound policies and regulations in order to attract FDI.

Second, the results demonstrate that contract enforcement has a positive but insignificant effect on FDI inflows to the GCC countries. This means that the efficiency of the court system

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<sup>978</sup> Samina Sabir et al., *Institutions and FDI: Evidence from Developed and Developing Countries*, 5 FINANCIAL INNOVATION 1, 1–20 (2019).

<sup>979</sup> Ourvashi Bissoon, *Can Better Institutions Attract More Foreign Direct Investment (FDI)? Evidence from Developing Countries*, 11 JOURNAL OF EUROPEAN ECONOMY 38, 38–61 (2012).

<sup>980</sup> Alemu Aye Mengistu & Bishnu Kumar Adhikary, *Does Good Governance Matter for FDI Inflows? Evidence From Asian Economies*, 17 ASIA PACIFIC BUSINESS REVIEW 281, 281–299 (2011).

<sup>981</sup> Daniel Kaufmann et al., *The Worldwide Governance Indicators: Methodology and Analytical Issues*, 3 HAGUE JOURNAL ON THE RULE OF LAW 220, 220–246 (2011).

<sup>982</sup> Tajul Ariffin Masron & Hussin Abdullah, *Institutional Quality As a Determinant for FDI Inflows: Evidence From ASEAN*, 2 WORLD JOURNAL OF MANAGEMENT 115, 115–128 (2010).

(in terms of time and cost) has no significant effect on FDI inflows to the GCC countries. This result is in line with the work of Morris and Aziz (2011)<sup>983</sup> and Jovanovic and Jovanovic (2017).<sup>984</sup> However, it contradicts the claims of Vogiatzoglou (2016)<sup>985</sup> and Gani and Al-Abri (2013),<sup>986</sup> who studied five GCC countries. The findings presented here also contradict those of Gani and Al-Abri (2013).<sup>987</sup> This discrepancy may be due to the fact that those authors examined five GCC countries, because their data only covers the period 2003–2010, because they measured contract enforcement by reference to time but not to cost, or because they used different variables to assess the business environment and institution quality.

Although the coefficient of contract enforcement is positive, as expected, it is insignificant. One potential explanation is that the efficiency of the local courts of the host country is not important because most international commercial disputes are resolved through arbitration (usually international arbitration). In other words, the efficiency of the host-country courts is not important for foreign investors because they are likely to avoid litigation before them. The question is not whether the quality of the courts matters to foreign investors but whether arbitral awards are enforced in the host country.

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<sup>983</sup> Rosetta Morris & Abdul Aziz, *Ease of Doing Business and FDI Inflow to Sub-Saharan Africa and Asian Countries*, 18 *CROSS CULTURAL MANAGEMENT: AN INTERNATIONAL JOURNAL* 400, 400–411 (2011).

<sup>984</sup> Branimir Jovanovic & Biljana Jovanovic, *Ease of Doing Business and FDI in the Ex-Socialist Countries*, 15 *INTERNATIONAL ECONOMICS AND ECONOMIC POLICY* 587, 587–627 (2018).

<sup>985</sup> Klimis Vogiatzoglou, *Ease of Doing Business and FDI Inflows in ASEAN*, 33 *JOURNAL OF SOUTHEAST ASIAN ECONOMIES* 343, 343–363 (2016).

<sup>986</sup> Azmat Gani & Almukhtar Saif Al-Abri., *Indicators of Business Environment, Institutional Quality and Foreign Direct Investment in Gulf Cooperation Council (GCC) Countries*, 27 *INTERNATIONAL REVIEW OF APPLIED ECONOMICS* 515, 515–530 (2013).

<sup>987</sup> *Id.*

All of the GCC countries are signatories to the New York Convention. Bahrain ratified the Convention in 1988,<sup>988</sup> Kuwait in 1978,<sup>989</sup> Oman in 1999,<sup>990</sup> Qatar in 2002,<sup>991</sup> Saudi Arabia in 1994,<sup>992</sup> and the UAE in 2006.<sup>993</sup> Under the New York Convention, contracting states are obliged to recognize arbitral awards as binding and enforceable.<sup>994</sup> Therefore, whenever an arbitral award is issued, the GCC countries must enforce it under the New York Convention. This research suggests that enforcement procedures, their duration, and the cost of enforcing contracts are not important to foreign investors in the GCC countries because arbitration has become a more popular means of resolving international business disputes and because the enforceability of international arbitral awards is not problematic in those countries.

Third, the results confirm H3—the ease of trading across borders has a positive association with FDI inflows to the GCC countries. This finding is in line with the conclusions of Morris and Aziz (2011),<sup>995</sup> Corcoran and Gillanders (2015),<sup>996</sup> Jovanovic and Jovanovic (2017),<sup>997</sup> and Vogiatzoglou (2016).<sup>998</sup> To my knowledge, this dissertation is the first study to measure this important factor (separately from the other EDB indicators) and to test its importance for the GCC countries. As previously explained, the variable trading across borders

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<sup>988</sup> New York Arbitration Convention, Contracting States, <https://www.newyorkconvention.org/countries> (last visited Oct. 09, 2021).

<sup>989</sup> *Id.*

<sup>990</sup> *Id.*

<sup>991</sup> *Id.*

<sup>992</sup> *Id.*

<sup>993</sup> *Id.*

<sup>994</sup> United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 *Art.* (3).

<sup>995</sup> Rosetta Morris & Abdul Aziz, *Ease of Doing Business and FDI Inflow to Sub-Saharan Africa and Asian Countries*, 18 *CROSS CULTURAL MANAGEMENT: AN INTERNATIONAL JOURNAL* 400, 400–411 (2011).

<sup>996</sup> Adrian Corcoran & Robert Gillanders, *Foreign Direct Investment and the Ease of Doing Business*, 151 *REV WORLD ECON* 103, 103–126 (2015).

<sup>997</sup> Branimir Jovanovic & Biljana Jovanovic, *Ease of Doing Business and FDI in the Ex-Socialist Countries*, 15 *INTERNATIONAL ECONOMICS AND ECONOMIC POLICY* 587, 587–627 (2018).

<sup>998</sup> Klimis Vogiatzoglou, *Ease of Doing Business and FDI Inflows in ASEAN*, 33 *JOURNAL OF SOUTHEAST ASIAN ECONOMIES* 343, 343–363 (2016).

measures the documentary burden, the time, and the cost of exporting and importing goods to or from the host country. The results confirm that foreign investors choose locations to which they can import and from which they can export efficiently. There are two possible explanations for this result. First, if an MNE is an efficiency-seeking investor, it is plausible that it will seek locations where it can export products efficiently. Second, if an MNE is a market-seeking investor, it will attempt to identify jurisdictions to which it can import products without incurring high transaction costs. Therefore, the results suggest that MNEs seek out locations that offer efficient international trade rules in order to reduce transaction costs.

Fourth, in line with H4, the results showed that the number of BITs has a significant positive association with FDI inflows to the GCC countries. The higher the number of BITs that a GCC country has ratified, the more FDI inflows it receives. This conclusion accords with those of Salacuse and Sullivan (2005),<sup>999</sup> Neumayer and Spess (2005),<sup>1000</sup> and Shah (2018),<sup>1001</sup> but conflicts with the findings of Hallward-Driemeier (2003)<sup>1002</sup> and Mina (2010).<sup>1003</sup> The latter study by Mina focuses on the GCC countries, but covers a different period, uses a different estimation model, and controls for different variables. As previously noted, there is no consensus about the determinants of FDI, and no single theory explains why some countries attract more FDI than others. The reasons differ by MNEs and by host countries.<sup>1004</sup> Consequently, the variables that are examined in studies on this topic vary considerably. This variation, coupled

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<sup>999</sup> Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and their Grand Bargain*, 46 *HARV. INT'L LJ* 67, 67–130 (2005).

<sup>1000</sup> Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, 33 *WORLD DEVELOPMENT* 1567, 1567–1585 (2005).

<sup>1001</sup> Mumtaz Hussain Shah, *Bilateral Investment Treaties and Multinational Investors: Evidence from FDI in the MENA States*, 12 *PARADIGMS* 94, 94–102 (2018).

<sup>1002</sup> Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite* (World Bank Policy Research, Working Paper No. 3121, 2003).

<sup>1003</sup> Wasseem Mina, *Do Bilateral Investment Treaties Encourage FDI in the GCC Countries?*, 2 *AFRICAN REVIEW OF ECONOMICS AND FINANCE* 1, 1–29 (2010).

<sup>1004</sup> See *supra* Chapter 1 and Chapter 3.

with the use of different observation periods, makes the results of such studies difficult to compare.

As defined in Chapter 4, BITs are “agreements between two countries for the reciprocal encouragement, promotion, and protection of investments in each other’s territories by companies based in either country.”<sup>1005</sup> BITs function as commitment devices—a host country guarantees that it will protect foreign investors by providing rules that mitigate the risks that they face.<sup>1006</sup> In other words, BITs provide certainty and reduce the costs of uncertainty. Indeed, the results suggest that the ratification of BITs in the GCC countries provides certainty to MNEs and foreign investors, thereby reducing investment risk. Consequently, as a country enters into more BITs, it becomes more attractive as an FDI location.

### **6.7.2** *Macroeconomic Factors*

The results indicate that only two of the macroeconomic factors—population and GDP growth rate—have a significant positive correlation with FDI inflows to the GCC countries. GDP per capita has an insignificant negative effect on FDI inflows to the GCC countries, and inflation has an insignificant positive effect. On the following pages, I discuss the effects of each of these variables.

First, market size was captured in this study by population and GDP per capita. I expected that both indicators would have a significant positive effect on FDI inflows to the GCC

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<sup>1005</sup> UNCTAD, *DEVELOPMENT AND GLOBALIZATION: FACTS AND FIGURES (2004)* and KENNETH A. REINERT, *AN INTRODUCTION TO INTERNATIONAL ECONOMICS NEW PERSPECTIVES ON THE WORLD ECONOMY* at 258 (2<sup>nd</sup> ed. 2020).

<sup>1006</sup> Suzanne Kirayoglu, *The Bilateral Investment Treaty: Its Origins and Effects* (2014) (Ph.D. dissertation, Florida State University) (ProQuest) and Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 *INTERNATIONAL REVIEW OF LAW AND ECONOMICS* 107, 107–123 (2005) and UNCTAD, *BILATERAL INVESTMENT TREATIES IN THE MID-1990s* (1998) and THOMAS POLLAN, *LEGAL FRAMEWORK FOR THE ADMISSION OF FDI* at 73 (2006) and ANDREW PAUL NEWCOMBE & LLUÍS PARADEL, *LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT* at 41 (2009) and Helena Sprenger & Bouke Boersma, *The Importance of Bilateral Investment Treaties (BITs) When Investing in Emerging Markets*, 2014 *BUS. L. TODAY* 1, 1–4 (2014).

countries. However, only population had a strong positive correlation with FDI inflows. GDP per capita had an insignificant negative effect on FDI.

Population, as noted earlier in this chapter, was measured as *de facto* population—that is, all residents, including non-citizens, were counted. A large population gives MNEs more opportunities to offer services in the market, which is why population serves as a proxy for market size.<sup>1007</sup> Population is also connected to the purchasing capacity that determines the size of the internal market of the host country.<sup>1008</sup> The results confirm H6—there is a strong positive correlation between population and FDI inflows to the GCC countries. This result aligns with the previous findings of Alessandrini (2000)<sup>1009</sup> and Petrović-Randelović et al. (2017),<sup>1010</sup> and but contradicts those of Wilhelms (1998).<sup>1011</sup> However, these studies did not focus on the GCC countries.

The results thus confirm the market size hypothesis that was proposed by Balassa (1966)<sup>1012</sup> and developed by Scaperlanda and Mauer (1969).<sup>1013</sup> The hypothesis posits that larger markets allow MNEs more opportunities to realize economies of scale. Therefore, population is an important factor in the location decisions of MNEs and is critical to location advantage. This study confirms the hypothesis that GCC countries with larger populations attract more FDI.

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<sup>1007</sup> Nicholas Billington, *The Location of Foreign Direct Investment: An Empirical Analysis*, 31 APPLIED ECONOMICS 65, 65–76 (1999) and Manamba Epaphra, *An Econometric Analysis of the Determinants of Foreign Direct Investment in Africa*, 11 INTERNATIONAL JOURNAL OF ECONOMIC DEVELOPMENT 200, 200–245 (2018).

<sup>1008</sup> Marija Petrović-Randelović et al., *Market Size as a Determinant of the Foreign Direct Investment Inflows in the Western Balkans Countries*, 14 FACTA UNIVERSITATIS. SERIES: ECONOMICS AND ORGANIZATION 93, 93–104 (2017).

<sup>1009</sup> Sergio Alessandrini & Laura Resmini, *FDI in the Mediterranean Region: A Comparison with CEE Experience* (Munich Personal RePEc Archive, Paper No. 26103, 2000).

<sup>1010</sup> Marija Petrović-Randelović et al., *Market Size as a Determinant of the Foreign Direct Investment Inflows in the Western Balkans Countries*, 14 FACTA UNIVERSITATIS. SERIES: ECONOMICS AND ORGANIZATION 93, 93–104 (2017).

<sup>1011</sup> SASKIA KS WILHELMS & MORGAN STANLEY DEAN WITTER, *FOREIGN DIRECT INVESTMENT AND ITS DETERMINANTS IN EMERGING ECONOMIES* (1998).

<sup>1012</sup> Bela Balassa, *Exports and Economic Growth: Further Evidence*, 5 JOURNAL OF DEVELOPMENT ECONOMICS 181, 181–189 (1978) and Muhammad Azamand & Ling Lukman, *Determinants of Foreign Direct Investment in India, Indonesia and Pakistan: A Quantitative Approach*, 4 JOURNAL OF MANAGERIAL SCIENCES 31, 31–44 (2010).

<sup>1013</sup> Anthony E. Scaperlanda & Laurence J. Mauer, *The Determinants of US Direct Investment in the EEC*, 59 THE AMERICAN ECONOMIC REVIEW 558, 558–568 (1969).

The second proxy that I used to measure market size is GDP per capita. GDP per capita is indicative of economic development and efficiency in production. A significant positive correlation between GDP per capita and FDI inflows to the GCC countries was therefore expected. However, the results indicate that GDP per capita has an insignificant negative effect on FDI inflows. The insignificant effect of GDP per capita on FDI inflows is in line with the conclusions of Loree and Guisinger (1995),<sup>1014</sup> who drew on data from 1982, and Rana and Kebewar (2014),<sup>1015</sup> but contradicts those of Root and Ahmed (1979),<sup>1016</sup> Tsai (1994),<sup>1017</sup> and Petrović-Randelović et al. (2017),<sup>1018</sup> who all found a significant positive association between GDP per capita and FDI inflows. The result of this dissertation arguably supports Wilhelms's (1998) argument that FDI can tolerate "a low degree of economic development."<sup>1019</sup> Wilhelms (1998)<sup>1020</sup> found a strong negative association between GDP per capita and FDI inflows to 67 developing countries (including Oman, the only GCC country in the sample). This proposition could also be true in cases in which GDP per capita has an insignificant negative effect on FDI inflows, as in this study. This result suggest that FDI inflows to the GCC countries can occur even when GDP per capita is low.

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<sup>1014</sup> David W. Loree & Stephen E. Guisinger, *Policy and Non-Policy Determinants of US Equity Foreign Direct Investment*, 26 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 281, 281–299 (1995).

<sup>1015</sup> Arslan Tariq Rana & Mazen Kebewar, *The Political Economy of FDI flows into Developing Countries: Does the depth of International Trade Agreements Matter?* (Munich Personal RePEc Archive, Paper No. 53358, 2014).

<sup>1016</sup> Franklin R. Root & Ahmed A. Ahmed, *Empirical Determinants of Manufacturing Direct Foreign Investment in Developing Countries*, 27 ECONOMIC DEVELOPMENT AND CULTURAL CHANGE 751, 751–767 (1979).

<sup>1017</sup> Pan-Long Tsai, *Determinants of Foreign Direct Investment and its Impact on Economic Growth*, 19 JOURNAL OF ECONOMIC DEVELOPMENT 137, 137–163 (1994).

<sup>1018</sup> Marija Petrović-Randelović et al., *Market Size as a Determinant of the Foreign Direct Investment Inflows in the Western Balkans Countries*, 14 FACTA UNIVERSITATIS. SERIES: ECONOMICS AND ORGANIZATION 93, 93–104 (2017).

<sup>1019</sup> SASKIA KS WILHELMS & MORGAN STANLEY DEAN WITTER, *FOREIGN DIRECT INVESTMENT AND ITS DETERMINANTS IN EMERGING ECONOMIES* at 28 (1998).

<sup>1020</sup> *Id.*

The insignificant effect of GDP per capita on FDI inflows is especially pronounced when a low GDP per capita is associated with a large population. In fact, Edwards (1990)<sup>1021</sup> suggested that “countries with lower income per capita, larger internal markets, and domestic investment ratios will tend to be more attractive to [FDI].”<sup>1022</sup> Moreover, Alsan et al. (2006),<sup>1023</sup> in their research on the association between population health and FDI inflows to low- and middle-income countries, used population and GDP per capita as two of their independent variables. They found that GDP per capita does not have a significant effect on FDI inflows, whereas the effect of total population is significant, which aligns with the results of the present study. They concluded that “The lack of significance of GDP per capita could be due to a balancing of the market size effect with the cost of production effect, which should work in the opposite direction.”<sup>1024</sup> In the present study, there is a strong positive association between population and FDI inflows and an insignificant negative association between GDP per capita and FDI inflows.

For example, Saudi Arabia received a higher volume of FDI than Qatar in the study period. During this period, Saudi Arabia had a lower GDP per capita rate and a larger population on average, and Qatar had a higher GDP per capita rate and a lower population. This case suggests that a country with low GDP per capita and a large internal market (as measured by population) is likely to attract more FDI than a country with high GDP per capita and a low population.

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<sup>1021</sup> Sebastian Edwards, *Capital Flows, Foreign Direct Investment, and Debt-Equity Swaps in Developing Countries* (National Bureau of Economic Research, Working Paper No. w3497, 1990).

<sup>1022</sup> *Id.*

<sup>1023</sup> Marcella Alsan et al., *The Effect of Population Health on Foreign Direct Investment Inflows to Low-and Middle-Income Countries*, 34 *WORLD DEVELOPMENT* 613, 613–630 (2006).

<sup>1024</sup> *Id.*

Third, in line with H5, the higher the GDP growth of a GCC country in the sample, the more FDI it attracted. GDP growth predicts the future potential of the market.<sup>1025</sup> This finding aligns with those of Schneider and Frey (1985),<sup>1026</sup> Culem (1988),<sup>1027</sup> Clegg (1995),<sup>1028</sup> Clegg and Scott-Green (1998),<sup>1029</sup> Billington (1999),<sup>1030</sup> Chakrabarti (2001),<sup>1031</sup> Choi (2003),<sup>1032</sup> Mottaleb (2007),<sup>1033</sup> and Majeed and Ahmad (2009).<sup>1034</sup> It contradicts the results of Nigh (1988),<sup>1035</sup> Tsai (1994),<sup>1036</sup> Shamsuddin (1994),<sup>1037</sup> and Hussan (2017),<sup>1038</sup> who found that GDP growth has an insignificant impact on FDI inflows. However, with the exception of Hussan (2017),<sup>1039</sup> none of the previous studies in question included the GCC countries in their samples. Furthermore, while Hussan (2017) did study the GCC countries, he also examined other Middle

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<sup>1025</sup> Muhammad Tariq Majeed & Eatnaz Ahmad, *FDI and Exports in Developing Countries: Theory and Evidence*, 46 THE PAKISTAN DEVELOPMENT REVIEW 735, 735–750 (2007).

<sup>1026</sup> Friedrich Schneider & Bruno S. Frey, *Economic and Political Determinants of Foreign Direct Investment*, 13 WORLD DEVELOPMENT 161, 161–175 (1985).

<sup>1027</sup> Claudy G. Culem, *The Locational Determinants of Direct Investments Among Industrialized Countries*, 32 EUROPEAN ECONOMIC REVIEW 885, 885–904 (1988).

<sup>1028</sup> Jeremy Clegg & Susan Scott-Green, *The Determinants of Japanese Foreign Direct Investment Flows to the European Community, 1963-1990*, 6 MULTINATIONAL LOCATION STRATEGY 29, 29–49 (1998).

<sup>1029</sup> *Id.*

<sup>1030</sup> Nicholas Billington, *The Location of Foreign Direct Investment: An Empirical Analysis*, 31 APPLIED ECONOMICS 65, 65–76 (1999).

<sup>1031</sup> Avik Chakrabarti, *The Determinants of Foreign Direct Investments: Sensitivity Analyses of Cross-Country Regressions*, 54 KYKLOS 89, 89–114 (2001).

<sup>1032</sup> Changkyu Choi, *Does the Internet Stimulate Inward Foreign Direct Investment?*, 25 JOURNAL OF POLICY MODELING 319, 319–326 (2003).

<sup>1033</sup> Khondoker Abdul. Mottaleb, *Determinants of Foreign Direct Investment and its Impact on Economic Growth in Developing Countries* (Munich Personal RePEc Archive, Paper No. 9457, 2007).

<sup>1034</sup> Muhammad Tariq Majeed & Eatnaz Ahmad, *An Analysis of Host Country Characteristics that Determine FDI in Developing Countries: Recent Panel Data Evidence*, 14 LAHORE JOURNAL OF ECONOMICS 71, 71–96 (2009).

<sup>1035</sup> Douglas Nigh, *The Effect of Political Events on United States Direct Foreign Investment: A Pooled Time-Series Cross-Sectional Analysis*, 16 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 1, 1–17 (1985)

<sup>1036</sup> Pan-Long Tsai, *Determinants of Foreign Direct Investment and its Impact on Economic Growth*, 19 JOURNAL OF ECONOMIC DEVELOPMENT 137, 137–163 (1994).

<sup>1037</sup> Abul F. M. Shamsuddin, *Economic Determinants of Foreign Direct Investment in Less Developed Countries*, 33 THE PAKISTAN DEVELOPMENT REVIEW 41, 41–51 (1994).

<sup>1038</sup> Munir Hassan, *Determinants of Foreign Direct Investment in the Middle East Region: An Empirical Analysis*, 13 ASIAN SOCIAL SCIENCE 47, 47–53 (2017).

<sup>1039</sup> *Id.*

Eastern countries and used a random-effects estimation model.<sup>1040</sup> In addition, the variables that he controlled for were different.<sup>1041</sup>

The positive significant effect of GDP growth on FDI inflows to the GCC countries in this study confirms the claim that some market-seeking foreign investors are interested not only in market size but also in growth rates, in market potential.<sup>1042</sup>

Fourth, the results indicate that the inflation rate in the GCC countries has a positive but insignificant effect on FDI inflows. This insignificant effect of inflation on FDI aligns with the results obtained by Hussan (2017),<sup>1043</sup> whose study focused on nine Middle Eastern countries (including all six GCC countries), and with those of Alshamsi, Hussin, and Azam (2015),<sup>1044</sup> who focused on the UAE. The authors provided possible explanations that are similar to those given by Obiamaka and Omankhanlen (2011):<sup>1045</sup> The inflation rate has no effect on FDI if it does not exceed a certain threshold.<sup>1046</sup> These results in the present study also contradict the findings of Ahn and Willett (1998)<sup>1047</sup> and Zhao, Delios, and Yang (2002).<sup>1048</sup> However, those studies did not focus on the GCC countries. Therefore, the determinants of FDI were different.

Table 6.7 summarizes the results on the substantive hypotheses.

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<sup>1040</sup> *Id.*

<sup>1041</sup> *Id.*

<sup>1042</sup> UNCTAD, *WORLD INVESTMENT REPORT 1998: TRENDS AND DETERMINANTS* (1998) and UNCTAD, *CROSS-BORDER MERGERS AND ACQUISITIONS AND DEVELOPMENT* (2000).

<sup>1043</sup> Munir Hassan, *Determinants of Foreign Direct Investment in the Middle East Region: An Empirical Analysis*, 13 *ASIAN SOCIAL SCIENCE* 47, 47–53 (2017).

<sup>1044</sup> Khamis Hareb Alshamsi et al., *The Impact of Inflation and GDP Per Capita on Foreign Direct Investment: The Case of United Arab Emirates*, 12 *INVESTMENT MANAGEMENT AND FINANCIAL INNOVATIONS* 132, 132–141 (2015).

<sup>1045</sup> Samuel Edoumiekumo, *Foreign Direct Investment and Economic Growth in Nigeria: a Granger Causality Test*, 7 *JOURNAL OF RESEARCH IN NATIONAL DEVELOPMENT* 114, 114–123 (2009).

<sup>1046</sup> Khamis Hareb Alshamsi et al., *The Impact of Inflation and GDP Per Capita on Foreign Direct Investment: The Case of United Arab Emirates*, 12 *INVESTMENT MANAGEMENT AND FINANCIAL INNOVATIONS* 132, 139 (2015).

<sup>1047</sup> Young Seok Ahn et al., *The Effects of Inflation and Exchange Rate Policies on Direct Investment to Developing Countries*, 12 *INTERNATIONAL ECONOMIC JOURNAL* 95, 95–104 (1998).

<sup>1048</sup> Changhui Zhou et al., *Locational Determinants of Japanese Foreign Direct Investment in China*, 19 *ASIA PACIFIC JOURNAL OF MANAGEMENT* 63, 63–86 (2002).

**Table 6.7** *Summary of the hypotheses tests*

<b>Variable</b>	<b>Measurement</b>	<b>Source</b>	<b>Hypothesis</b>	<b>Result</b>
<b>Regulatory quality</b>	The ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development	Worldwide Governance Indicators	+	Supported
<b>Enforcing contracts</b>	Procedures, time, and cost of enforcing a debt contract	Doing Business	+	Not supported
<b>Trading across borders</b>	Number of documents, cost, and time necessary to export and import goods	Doing Business	+	Supported
<b>BITs</b>	The number of BITs that were in force in each year less the number of BITs that were terminated in that year	Calculated by the author on the basis of data from the Investment Policy Hub by the United Nations Conference on Trade and Development	+	Supported
<b>GDP per capita</b>	GDP in constant 2010 US dollars divided by population	World Bank World Development Indicators	+	Not supported

<b>Population</b>	<i>De facto</i> population, counting all residents of the country, including both citizens and non-citizens	World Bank World Development Indicators	+	Supported
<b>GDP growth</b>	Changes in market prices assuming a consistently valued local currency	World Bank World Development Indicators	+	Supported
<b>Inflation rate</b>	The annual growth rate of the GDP implicit deflator	World Bank World Development Indicators	-	Not supported

Together, the findings above serve to answer the third sub-question of the research: **What are the determinants of FDI in the GCC countries?** According to the results of this study, the determinants of FDI in the GCC countries are regulatory quality, trading across borders, the number of BITs, population, and GDP growth. The other variables that were tested—enforcing contracts, GDP per capita, and the inflation rate—exerted an insignificant influence on FDI inflows.

Furthermore, the main research question asked **whether business-facilitating legal institutions play a role in attracting FDI inflows to the GCC countries.** The findings demonstrate that business-facilitating legal institutions do play a significant role in attracting FDI inflows to GCC countries. Three of the four legal variables—regulatory quality, trading across borders, and the number of BITs—exhibit a significant positive relationship with FDI inflows. In other words, the higher the quality of the business-facilitating legal institutions of a GCC country, the more FDI it receives. These results cohere with the theoretical framework of this study, which highlights that both macroeconomic factors and institutional quality in the host

country matter for MNEs' location advantages and FDI inflows. Effective institutions, which are certain and efficient, reduce transaction costs, thus promoting foreign investment and attracting FDI inflows. Moreover, the results clearly indicate that the quality of business-facilitating legal institutions can make one location more attractive for investors than another. Therefore, it is safe to assume that GCC countries can receive more FDI by ratifying BITs, improving regulatory quality, and relaxing rules on cross-border trade.

## Chapter 7. CONCLUSION

*This chapter summarizes the key findings of the study by reference to the aims of the research and its questions. It also discusses the theoretical value of the dissertation and its practical contribution. The chapter subsequently highlights the limitations of this research and provides recommendations for future studies before concluding with a closing summary.*

### 7.1 STUDY FINDINGS

Dunning's OLI paradigm, also known as the eclectic theory, provides a three-tiered paradigm that explains when and where MNEs choose FDI as an entry mode. One of these tiers is location advantage. Dunning argued that the location advantages that an MNE can gain make some locations more attractive for FDI than others.<sup>1049</sup> Location advantage can depend on various considerations, including economic and institutional factors. Dunning noted that "MNEs are increasingly seeking locations which offer the best economic and institutional facilities for their core competencies to be efficiently utilized."<sup>1050</sup> Researchers, in attempting to identify the drivers of FDI, have empirically tested different economic and institutional (legal and/or political) variables and their effects on MNEs' location decisions and FDI inflows.

In this dissertation, I argued that business-facilitating legal institutions affect FDI inflows to the GCC countries. I used the term "business-facilitating legal institutions" to denote the formal rules (laws and regulations) of host countries that facilitate and support foreign businesses. In order to answer my research question, I considered three sub-questions.

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<sup>1049</sup> JOHN H. DUNNING & SARIANNA M. LUNDAN, *MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY* at 128–129 (2<sup>nd</sup> ed. 2008).

<sup>1050</sup> John H. Dunning, *Location and the Multinational Enterprise: A Neglected Factor?*, 29 *JOURNAL OF INTERNATIONAL BUSINESS STUDIES* 45, 45–66 (1998).

The first sub-question, which I discussed in Chapter 4, concerns the international legal framework governing foreign investment in the GCC countries. The dissertation discussed three types of international investment instruments that are used in those states: BITs, RIAs, and EIAs. First, each GCC country has signed a different number of BITs. The UAE has concluded the highest number of BITs (108), followed by Kuwait (92), Qatar (62), Oman (38), Bahrain (33), and Saudi Arabia (25).

RIAs are the second type of international investment instruments. The GCC countries are signatories to two important RIAs: the Unified Agreement for the Investment of Arab Capital in the Arab States and the Agreement on Promoting, Protection, and Guarantee of Investment among the Member States of the Organization of the Islamic Conference.

The third type of international investment instrument that I discussed in this research is EIAs. The GCC intraregional EIA is the UEA between the Countries of the GCC. The extraregional EIAs of these countries are of two types: FTAs with investment-related provisions and framework agreements on economic cooperation. In the GCC countries, there are two types of FTAs. In some cases, an individual GCC state enters into an FTA with another country (country-country FTA). Only two GCC countries, Bahrain and Oman, have entered into such FTAs. Both treaties were concluded with the US (the US-Bahrain FTA and the US-Oman FTA). FTAs can also be concluded between the GCC as a union and other countries or unions (group-state and group-group FTAs). Examples include the GCC-Lebanon FTA of 2004, the GCC-Singapore FTA of 2008, and the GCC-European Free Trade Association of 2009, an interregional agreement. The FTA with Singapore entered into force in 2013. The other two FTAs were signed but are not yet in force. However, none of the three FTAs contain extensive investment provisions. Therefore, they are considered to be EIAs rather than EIAs. Lastly, the

GCC has entered into framework agreements on economic cooperation with three countries: Peru, the US, and India. However, none of those agreements are currently in force.

The second sub-question concerns the legal framework that governs FDI in the GCC countries, discussed in Chapter 5. I first detailed the historical development of the laws of each country. Bahrain is the only GCC country that does not have laws that are designed to regulate and organize FDI. FDI in Bahrain is primarily regulated by the Commercial Companies Law. Kuwait has passed two sets of laws that regulate FDI. The first is the Regulating Direct Investment in the State of Kuwait Law, which was passed in 2001.<sup>1051</sup> This law was then replaced by the Kuwait Direct Investment Promotion Authority Law of 2013.<sup>1052</sup> Oman has also issued two codes that regulate FDI. The first is the Foreign Capital Investment Law of 1994.<sup>1053</sup> In 2019, Oman passed a new Foreign Capital Investment Law.<sup>1054</sup> Qatar too has passed two laws on FDI. The first is the Organization of Foreign Capital Investment in Economic Activity Law of 2000,<sup>1055</sup> which was amended in 2005. In 2019, Qatar passed the Non-Qatari Capital Investment in Economic Activity Law,<sup>1056</sup> which replaced the 2000 law. Meanwhile, Saudi Arabia passed its first law on FDI in 1979, the Foreign Capital Investment Law.<sup>1057</sup> This law was replaced by the Foreign Investment Law in 2000.<sup>1058</sup> In 2019, the Saudi legislature introduced a bill for a new Foreign Investment Law. However, at the time of writing, that law has not been implemented. Finally, before 2018, foreign investment in the UAE was regulated by several codes, including the UAE Commercial Companies Law of 2015 and the local tax, agency, and customs laws of

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<sup>1051</sup> Regulating Direct Investment in the State of Kuwait, Law No. (8) of 2001 (Apr. 17, 2001).

<sup>1052</sup> Kuwait Direct Investment Promotion Authority Law, Law No. (116) of 2013 (June 16, 2013).

<sup>1053</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (102) of 1994 (Oct. 16, 1994).

<sup>1054</sup> Oman Foreign Capital Investment Law, Sultani Decree No. (50) of 2019 (July 1, 2019).

<sup>1055</sup> Qatar Organization of Foreign Capital Investment in Economic Activity, Law No. (13) of 2000 (Nov. 25, 2000).

<sup>1056</sup> The Non-Qatari Capital Investment in the Economic Activity Law, Law No. (1) of 2019 (Jan. 1, 2019).

<sup>1057</sup> Saudi Arabia Foreign Capital Investment Law, Royal Decree No. M/4, 2 *Safar* 1399 A.H. (Jan. 1, 1979).

<sup>1058</sup> Saudi Arabia Foreign Investment Law, Royal Decree No. M/1, 5 *Muharram* 1421 A.H. (Apr. 10, 2000).

the seven emirates. In 2018, the UAE passed the Foreign Investment Law to govern foreign investment in the country,<sup>1059</sup> and in 2020, it amended the Commercial Companies Law of 2015.<sup>1060</sup> These amendments replaced the FDI Law of 2018. Then, in 2021, the UAE passed the new Commercial Companies Law,<sup>1061</sup> which is currently the main source of FDI regulations in the country.

Chapter 5 also compared the current laws and regulations governing FDI of the six GCC countries on the basis of nine parameters: 1) the foreign ownership of capital, 2) the form of the legal entity of the foreign investor, 3) the application of the national treatment principle, 4) the corporate tax regime, 5) tariff and customs duty exemptions, 6) the transferability of capital and earnings, 7) the time and cost of starting a business, 8) real estate ownership, and 9) free trade zones. Among the GCC countries, the UAE has the legal framework that is most conducive to FDI, while Kuwait has the most restrictive legal framework for FDI.

The third sub-question required me to identify the determinants of FDI in the GCC countries. In order to answer this sub-question, I used a time-series cross-section analysis and a sample of six GCC countries covering the 2008–2017 period. I included three categories of variables: business-facilitating legal institutions, macroeconomic factors, and political factors (as controls). Business-facilitating legal institutions were captured by investment and business laws and regulations, court efficiency, trading across borders, and the number of BITs. I measured macroeconomic factors by market size (by reference to GDP per capita and population), GDP growth, and the inflation rate. Finally, I controlled for the following political variables: political stability, control over corruption, and property rights.

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<sup>1059</sup> United Arab Emirates Foreign Investment Law, Federal Law No. (19) of 2018.

<sup>1060</sup> Amending Certain Provisions of Federal Law No. (2) of 2015 on Commercial Companies of the United Arab Emirates, Federal Law No. (26) of 2020 (Sept. 26, 2020).

<sup>1061</sup> The Commercial Companies Law of the United Arab Emirates, Federal Law No. (32) of 2021 (Sept. 20, 2021).

The regression results indicate that the determinants of FDI in the GCC countries are regulatory quality, trading across borders, the number of BITs, population, and GDP growth. The other variables tested—enforcing contracts, GDP per capita, and the inflation rate—exhibit an insignificant effect on FDI inflows.

Finally, the main question that animates this dissertation is whether business-facilitating legal institutions play a role in attracting FDI inflows to the GCC countries. The regression results confirm that business-facilitating legal institutions play a significant role in attracting FDI inflows. In particular, regulatory quality, trading across borders, and the number of BITs were shown to have a significant and positive association with FDI inflows to the GCC countries. Therefore, it is safe to assume that the GCC countries will receive more FDI when they ratify further BITs, when they improve regulatory quality, and when they adopt more permissive cross-border trading rules.

The results support the argument that macroeconomic factors are not the sole determinants of MNEs' location advantage and FDI inflows to the GCC countries. The quality of host-country institutions also matters. Appropriate institutions, which are certain and efficient, reduce transaction costs, thus promoting foreign investment and attracting FDI inflows. Therefore, institutional quality shapes location decisions and FDI inflows.

## **7.2 CONTRIBUTIONS OF THE STUDY**

Research on the determinants of FDI and of the location decisions of MNEs is still in its infancy. No single theory can comprehensively explain MNE location decisions and FDI inflows. In this dissertation, I attempted to fill the gap in the literature on FDI in the GCC region by arguing that the quality of business-facilitating legal institutions is a determinant of FDI inflows to the countries under observation. The dissertation offers six novel contributions to the literature.

First, I focused on the GCC countries. Most studies on the determinants of FDI group the GCC countries with other Arab countries by focusing on the MENA region or on all Arab states.<sup>1062</sup> However, the unique economic and institutional situation of the GCC countries means that studying them alongside others requires the use of extensive controls. The number of parameters that would have to be estimated is so large that it could lead to bias. Studying the determinants of FDI within groups of countries that share economic and institutional characteristics yields more plausible answers to questions about FDI flows.

Second, I focused on business-facilitating legal institutions as determinants of FDI in the GCC countries. Most studies on the determinants of FDI in the GCC test macroeconomic and institutional variables that are, for the most part, political rather than legal.<sup>1063</sup> The business-facilitating legal institutions that I examined here enabled me to draw a distinction between political institutions (such as political stability, corruption, and expropriation) and legal factors that are conducive to business (the main focus of this study). Unlike many authors who write on FDI in the GCC, I focused on business-facilitating laws and regulations as determinants of FDI in the GCC countries.

Third, I measured business-facilitating legal institutions by using four variables: regulatory quality, court efficiency, trading across borders, and the number of BITs. This method represents a contribution to the literature for two reasons. First, these four variables have not

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<sup>1062</sup> Sufian Eltayeb Mohamed & Moise G. Sidiropoulos, *Another Look at the Determinants of Foreign Direct Investment in MENA Countries: An Empirical Investigation*, 35 JOURNAL OF ECONOMIC DEVELOPMENT 75, 75–90 (2010) and Omar G Aziz & Anil V. Mishra, *Determinants of FDI Inflows to Arab Economies*, 25 THE JOURNAL OF INTERNATIONAL TRADE & ECONOMIC DEVELOPMENT 325, 325–356 (2016) and Munir Hassan, *Determinants of Foreign Direct Investment in the Middle East Region: An Empirical Analysis*, 13 ASIAN SOCIAL SCIENCE 47, 47–53 (2017) and Omar Ghazy Aziz, *Institutional Quality and FDI Inflows in Arab Economies*, 25 FINANCE RESEARCH LETTERS 111, 111–123 (2018).

<sup>1063</sup> Wasseem Mina, *The Location Determinants of FDI in the GCC Countries*, 17 JOURNAL OF MULTINATIONAL FINANCIAL MANAGEMENT 336, 336–348 (2007) and Mohamed Mahjoub Elheddad, *Natural Resources and FDI in GCC Countries*, 6 INTERNATIONAL JOURNAL OF BUSINESS AND SOCIAL RESEARCH 12, 12–22 (2016).

been tested together in GCC and non-GCC countries, but have been shown to affect FDI inflows when tested separately.<sup>1064</sup> Second, regulatory quality<sup>1065</sup> and trading across borders<sup>1066</sup> have never been tested as determinants of FDI in the GCC countries, but have been shown to affect FDI in other countries. This dissertation is the first study that tests the two variables in the GCC countries.

Fourth, I discussed the international legal framework governing FDI in the GCC countries. I developed an analysis of the contemporary international investment instruments in the region. This work also provided a foundation for a complete study of the FDI legal framework in the GCC.

Fifth, I described the historical development of the laws and regulations on FDI in each GCC country. To the best of my knowledge, no study has provided such an overview among the six states.

Sixth, I compared the current legal frameworks that govern FDI in the GCC states. To my knowledge, no prior study has made such comparisons.

### **7.3 LIMITATIONS AND RECOMMENDATIONS FOR FUTURE RESEARCH**

This research has some limitations, which create opportunities for future research.

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<sup>1064</sup> See *supra* Chapter 3.

<sup>1065</sup> Ourvashi Bissoon, *Can Better Institutions Attract More Foreign Direct Investment (FDI)? Evidence from Developing Countries*, 11 JOURNAL OF EUROPEAN ECONOMY 38, 38–61 (2012) and Samina Sabir et al., *Institutions and FDI: Evidence from Developed and Developing Countries*, 5 FINANCIAL INNOVATION 1, 1–20 (2019) and Alemu Aye Mengistu & Bishnu Kumar Adhikary, *Does Good Governance Matter for FDI Inflows? Evidence From Asian Economies*, 17 ASIA PACIFIC BUSINESS REVIEW 281, 281–299 (2011).

<sup>1066</sup> Katherine Piwonski, *Does the ‘Ease of Doing Business’ in a Country Influence its Foreign Direct Investment Inflows?* (2010) (Senior Capstone Project, Bryant University) (on file with author) and Rosetta Morris & Abdul Aziz, *Ease of Doing Business and FDI Inflow to Sub-Saharan Africa and Asian Countries*, 18 CROSS CULTURAL MANAGEMENT: AN INTERNATIONAL JOURNAL 400, 400–411 (2011) and Klimis Vogiatzoglou, *Ease of Doing Business and FDI Inflows in ASEAN*, 33 JOURNAL OF SOUTHEAST ASIAN ECONOMIES 343, 343–363 (2016) and Adrian Corcoran & Robert Gillanders, *Foreign Direct Investment and the Ease of Doing Business*, 151 REV WORLD ECON 103, 103–126 (2015) and Branimir Jovanovic & Biljana Jovanovic, *Ease of Doing Business and FDI in the Ex-Socialist Countries*, 15 INTERNATIONAL ECONOMICS AND ECONOMIC POLICY 587, 587–627 (2018).

First, I used a relatively small sample. There are two ways to increase the sample size. One can add countries to the sample or extend the observation period. I could not increase the number of countries in my sample because I was only concerned with the GCC countries. The addition of further countries would have required me to control for additional factors that affect FDI inflows and to analyze countries that are outside of the scope of my study. Extending the observation period was also not feasible due to the unavailability of data prior to 2008 and after 2017. Therefore, I recommend conducting the same analysis of the GCC countries over a longer period to determine whether the results of the present study are reliable.

Second, when I ran sensitivity tests to assess the robustness of the regression results, I excluded the UAE data from the dataset. The outcomes for cross-border trade and contract enforcement remained the same as in the base model. The coefficient of regulatory quality remained positive, but decreased. The coefficient of BITs was also lower. These results may indicate that the significance of regulatory quality and BITs in the base model could have been primarily driven by the UAE data for those variables. Further investigations should be performed to determine whether this explanation is accurate.

Third, I measured business-facilitating institution legal institutions by using four variables: investment and business laws and regulations, court efficiency, trading across borders, and the number of BITs. Intellectual property law and labor law can also influence FDI inflows and the location decisions of MNEs. The literature indicates that the quality of intellectual property law can influence FDI inflows both positively and negatively.<sup>1067</sup> Moreover, the Saudi

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<sup>1067</sup> See Jeong-Yeon Lee & Edwin Mansfield, *Intellectual Property Protection and US Foreign Direct Investment*, 78 THE REVIEW OF ECONOMICS AND STATISTICS 181, 181–186 (1996) and Keith E. Maskus, *Intellectual Property Rights and Foreign Direct Investment* (Centre for International Economic Studies, Working Paper No. 22, 2000) and Beata Smarzynska Javorcik, *The Composition of Foreign Direct Investment and Protection of Intellectual Property Rights: Evidence from Transition Economies*, 48 EUROPEAN ECONOMIC REVIEW 39, 39-62 (2004) and Judy Hsu & Yu-En Tiao, *Patent Rights Protection and Foreign Direct Investment in Asian Countries*, 44 ECONOMIC MODELLING 1, 1–6 (2015) and Belay Seyoum, *The Impact of Intellectual Property Rights on Foreign Direct Investment*, 31 THE

and Omani lawyers who I interviewed posited that a labor-law quota for national employees could exert an adverse effect on the location decisions of MNEs. These quotas increase transaction costs and are viewed as a burden by businesses. However, due to the scope of this research and the unavailability of secondary data on those laws for the countries of interest, I could not analyze them as business-facilitating institution legal institutions. In the future, scholars should collect data on intellectual property and labor law and test their association with FDI inflows.

Fourth, the theories on FDI in the literature highlight the importance of institutions and the quality of regulation. However, the specific laws and regulations that matter the most for the location decisions of MNEs have yet to be identified.<sup>1068</sup> Different studies measure the institutional and legal determinants of FDI in different ways. I focused on business-facilitating legal institutions by examining the following variables: investment and business laws and regulations, court efficiency, trading across borders, and the number of BITs. I drew on the literature and quantitatively tested those variables. Another approach to identifying the laws and regulations that matter the most for the location decisions of MNEs would be to conduct a qualitative study, which was also my original intention. However, COVID-19 prompted me to cancel my travel plans, which made collecting the necessary data impossible.

Qualitative research designs should be explored in the future in order to identify business-facilitating legal institutions. Such a design would entail conducting interviews and

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COLUMBIA JOURNAL OF WORLD BUSINESS 50, 50–59 (1996) and Thierry Mayer & Etienne Pfister, *Do Stronger Patent Rights Attract Foreign Direct Investment? Evidence from French Multinationals' Location*, 13 RÉGION ET DÉVELOPPEMENT 99, 99–122 (2001) and James Mitchell Watkins & Mark Zachary Taylor, *Intellectual Property Protection and US Foreign Direct Investment in Emerging Economies*, 15 JOURNAL OF INTELLECTUAL PROPERTY RIGHTS, 415, 415–428 (2010) and Dimitrios Kyrkilis & Sofia Koboti, *Intellectual Property Rights as Determinant of Foreign Direct Investment Entry Mode: The Case of Greece*, 19 PROCEDIA ECONOMICS AND FINANCE 3, 3–16 (2015).

<sup>1068</sup> See *supra* Chapter 3.

surveys with the in-house lawyers and executive managers of MNEs as well as with lawyers in the GCC countries. These interviews and surveys can identify a) the business regulations and laws that encourage and discourage FDI in each GCC state, b) the most pressing legal concerns for MNEs that are preparing to enter the GCC market, and c) the types of difficulties that MNEs experience after entering those markets. Regression analyses can then be conducted to test for associations between business-facilitating legal institutions and FDI inflows to the countries in question.

Fifth, this dissertation does not explain why the GCC countries have retained some barriers to business. Answering this question and analyzing variations in the level of openness to business in the region would require the collection of qualitative data. In the future, interviews should be conducted with government officials to identify the reasoning behind the retention of barriers.

Sixth, this dissertation mainly concerns the association between formal institutions, in particular business-facilitating legal institutions, and FDI inflows to the GCC countries. However, the institutions that affect FDI flows are not exclusively formal (e.g., laws, regulations, and judicial systems). Informal institutions—such as social norms, customs, and the traditions that shape thought in a society—are also relevant. In this dissertation, I accounted for informal institutions by adding a dummy variable  $\alpha_i$  to the regressions. This variable represents individual-specific unobserved heterogeneity, that is, the influence of factors that differ across units but are constant over time for each unit. Research on informal institutions as a determinant of FDI and of the location decisions of MNEs is lacking. My own practice indicates that some MNEs prefer to locate their headquarters in a culturally open country rather than in the

country with the largest market. Therefore, the relationship between informal institutions, MNEs' location decisions, and FDI inflows calls for further research.

#### **7.4 CLOSING SUMMARY**

This dissertation is a multidisciplinary study of law, economic, and politics. I attempted to determine whether business-facilitating legal institutions play a role in attracting FDI inflows to the GCC countries, which are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE. I used panel-data analysis to investigate the relationship between business-facilitating legal institutions—which I measured by reference to investment and business laws and regulations, court efficiency, trading across borders, and the number of BITs—and FDI flows. I also considered macroeconomic variables, including market size (measured by GDP per capita and population), GDP growth, and the inflation rate. In addition, I controlled for political stability, control over corruption, and property rights. The results indicate that the determinants of FDI in the GCC countries are regulatory quality, trading across borders, the number of BITs, population, and GDP growth. The remaining variables—contract enforcement, GDP per capita, and the inflation rate—exhibit an insignificant effect on FDI inflows. I also examined the IIAs that the GCC countries have entered into, conducted a historical analysis of the legal frameworks that govern FDI in the GCC countries, and compared the countries' current laws on FDI.

My conclusion is that business-facilitating legal institutions play a significant role in attracting FDI inflows to the GCC countries. I hope that this dissertation has improved the current understanding of the legal frameworks that govern FDI, both internationally and at the domestic level, in one of the most promising economies in the world. I also hope that this dissertation contributes to studies on plans for the economic diversification of the GCC.

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