MARGIN OF ECONOMIC FREEDOM IN THE GCC: IS IT ENOUGH TO ATTRACT FDI

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dx.doi.org/10.18374/JIFE-21-1.2

ABSTRACT

The paper aims to examine the determinants of Foreign Direct Investment in the Gulf Cooperation Council and explore whether the margin of economic freedom in the GCC is enough to attract FDI from the period 2000-2018. The data was collected from secondary sources of the World Bank databases and the United Nations Conference on Trade and Development. To explain the link between FDI and economic freedom in the long and short run, the study used different models of cointegration including VECM, FMOLS, DOLS, FMLS. The study found that there exists a long relationship between FDI and Gross Domestic Product (GDP) per capita, gross fixed capital formation, inflation, degree of openness and economic freedom. The degree of adjustment was found to be 0. 37 percent, meaning that any deviation for FDI from its long run path will be corrected by 0.37 percent each year.

The study also confirmed that GDP per capita, and gross fixed capital formation, and degree of openness have a positive impact on FDI, whereas inflation and economic freedom have a negative impact. The implication of the study is that the margin of economic freedom in the GCC is not that large enough to attract more FDI. The GCC must introduce many policy and institutional reforms to attract more FDI which will facilitate the economic diversification of the GCC economies and foster their economic growth and development.

Keywords: *Economic freedom, FDI, VECM, FMOLS, DOLS, GCC*

1. INTRODUCTION

Foreign Direct Investment (FDI) has been perceived as an engine of growth as it provides the recipient countries with modern technology, extra finance, new managerial and organization systems, and links with global market (Abraham & Muazu, 2019; Adegboye et al., 2020; IMF, 2018; Nguyen et al., 2019). What motivates the FDI has been and still an area of research and debate among scholars and policy makers. Understanding these motivations will help countries to devise effective strategies to attract FDI and reap its benefits. Classical determinants of market and resources seeking such as location, wages, infrastructure or macroeconomic policy are no longer appealing to investors as two decades ago. There has been a shift paradigm in FDI toward efficiency seeking motives (Dunning, 2002). Institutional and economic freedom have been widely claimed nowadays as critical factors to attract FDI (Dkhili & Dhiab, 2018; Kurul & Yalta, 2017; Sabir et al.,2019).

There is consensus among international organizations and policy makers in the GCC that the heavy reliance of the GCC countries on oil expose them to economic risk of oil prices shocks and diversifying their sources would be strategic solution (IMF, 2018; World Bank, 2019). Considering the vulnerability of the GCC economies, the FDI is considered a catalyst not only for their economic diversification but also for achieving sustainable economic growth (Mazarei, 2019; Soofi et al., 2017; World Bank, 2019).

There is a great potential for the GCC to boost FDI inflows if proper measures have been taken to promote corporate governance standards, reduce red-tape burdens on foreign companies, lessen the role of the public sector, and improving economic freedom in their economies (Globerman & Shapiro, 2002).