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INVESTMENT: FDI FLOW IN THE ESCWA REGION

By

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1. Abstract

The primary purpose of the paper is to study Foreign Direct Investment flows in ESCWA member countries and to analyze the impact of changes in rules and regulations, owing to government policies, on the growth of FDI.
Secondarily, the paper intends to cite and analyze the effect of certain economical trends that have contributed to the FDI flow in the region.
Lastly, various strategies have been evolved to improve the situation based on the analysis.

2. Summary

'Now or never' will be the best phrase to describe the current situation in the ESCWA. The World Trade Organization (WTO) meeting is to be held in Qatar between November 9th and 13th and the IMF and World Bank meetings will be held in Dubai in 2003. Top Names, institutions, characters - All of them in the ESCWA region, will the region seize this opportunity to enhance and develop the image of ESCWA?

The ESCWA member countries have only managed to attract less than 7% from the total FDI flow headed towards Asia in year 2000, which reached a record US$141 billion. The situation is even more depressing if we exclude Saudi Arabia from the list, as the kingdom alone attracted more than 60% of the inflow. Nevertheless, through small steps of improvement, there has been an overall improvement in the FDI scenario in the region. Efforts in making markets more transparent, removing old regulations, updating them to match the present economic climate, opening up of new sectors to foreigners and privatization have become active.

Privatization, Free zones, Capital markets and M&As are the four primary channels that can be utilized to attract FDIs to the region, outside the oil and gas sector. With regard to Mergers and Acquisitions, despite the ongoing positive trend [(1)] on the global scale, most ESCWA countries do not believe in using M&A as a serious FDI attracting method and are consequently far behind the rest of the world in attracting FDIs through M&As. Hence, free trade zones and privatization are likely to play a dominant role in leading FDIs into the ESCWA region in the coming years.

This will lead us to assume that the FDI inflow will increase in the near future, especially, with the liberalization of the Saudi gas sector and the establishment of new technology hubs in the region. However, it still remains to be seen if our hopes are fulfilled or belied.

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1 – A $25 billion merger was signed between HP and Compaq on the 4th of September, 2001.

3. Introduction

Over the past five years, the Asian continent has witnessed a steep increase in Foreign Direct Investment flow – from a modest $74 billion in 1995, FDI inflow has grown to $141 billion in 2000, which represents 20% growth on a year-to-year basis. In addition, FDI flow had contributed to as much as 9% of the domestic capital formation in Asia by the end of the nineties, which is more than twice it's contribution at the beginning of the decade. Asia has been a forerunner in capturing FDIs ever since.

In comparison, the countries of the ESCWA have not been able to gain a foothold in the recent success that has prevailed in the continent ,especially, China which represents 30% of the FDI flows in Asia (UNCTAD Report 2000). China's dominance in the FDI market continues with its inward foreign investment in the first seven months of 2001 being $40.3 billion, an improvement of 46% over last year's ("Weekly Investor research" – August 23rd). A major cause of the paucity of the FDI flows to the ESCWA region has been the lack of professional understanding and expertise on FDI flows and the factors regulating them in the region.

Micro-economic approach could also be cited as a principal cause of the negative trend in FDI growth. As the GCC economies have been riding a wave of success since the 1980s ,owing to the incessant rise of oil prices from $10 to $25 over the past two decades, their GDPs have improved by as much as 20% and has hence led to the overall economic development of these economies. Theoretically this growth should have reflected in the development of non-oil producing ESCWA members (Egypt, Syria, Jordan and Yemen) due to intra-regional flow in trade, labor, remittance and financial and development aid (Deutsche Bank Research, Sep 2000). However this proved to be false to a large extent.

However, the ESCWA community in general and the GCC countries in particular have lately realized the importance of macro-economic stability and thus the importance of FDIs in economic development, as they not only initiate investments, but also facilitate technology transfer and upgradation. Hence, there is an evident need for FDI mobilization in the ESCWA countries.

The ESCWA region constitutes an important part of the global economy. Traditionally, the oil and gas sectors have been the most lucrative fields for foreign investment in this region. In the next 10 years, an investment of $950 billion is expected in this sector, worldwide, and the GCC countries' share 25% of these investments i.e. $237 billion. Countries such as Saudi Arabia have opened the door for foreign companies to invest in the gas, power generation and petrochemical industries. They have also welcomed companies to expand and upgrade their refineries. Such positive steps, which will be explained in detail in the following chapters, have successfully helped promote FDI flows in the region.

The FDI flow of the ESCWA states are divided into two groups:

1. Anti - FDI Attitude

These groups of people strongly believe that any foreign capital entering their country is a threat to their economical and political interests. This is because most ESCWA countries have become independent in the last 30 – 40 years; so there are people who still believe that induction of FDIs in their economic cycle is only a new age method of exploitation by imperialist countries. This negative attitude grew in the wake of the Asian economic crisis in 1997 and the resulting negative impact experienced by various nations. Another demoralizing factor has been that the FDI flows have not improved the unemployment scenario in these states as foreign establishments depend on cheap Asian manpower rather than local labor, which then turns out to be an additional burden to the governments.

2. Pro - FDI Attitude

As the performances of the local markets were unimpressive, these nations mobilized internal resources to motivate the economy. Lack of capital further undermined the stability of these economies. Therefore, these nations foresaw that new foreign capital would be required to build a base for a powerful industry and hence such governments wholeheartedly encouraged FDI flow.

Egypt, Jordan, Oman and Saudi Arabia are the major nations involved in FDIs in the ESCWA region. It is mainly undertaken in the oil sector (Oman), petrochemicals (Saudi Arabia), manufacturing, especially textiles, metals and minerals, and tourism (especially Egypt). The stocks of FDI inflows to GDP in all the four countries are comparable to that of the developing countries at 16.5%.

The benefits involved in initiating FDIs in a nation are numerous which on accumulation result in a strong, technologically sound, macro-economic economy. This further result in bringing the nation on the world trade map and gives the nation an opportunity to back its trade interests in the world trade scenario. This could also create an interest in economically large nations and their investors to further invest in the nation and thus improve the economic stability of the nation.

Yet, there are certain problems that plague the growth of FDIs in the ESCWA region. These problems as well as the solutions to overcome these hindrances will be discussed at length in the following sections from which we can derive conclusions on the path to be taken to improve the present FDI situation and thus achieve overall economic development.

4. FDI Flow Determinants In The ESCWA Region

In the first 9 months of 2001, the ESCWA region has probably received more global attention due to its regional political crisis [1] rather than any other enhancements in its regional economic welfare. Whereas, all over the world, developing countries are making significant advances in attracting FDI flows.

From 1990 to 1998, the developing world share of the global stock of FDI had increased from 21% to 30%. However, 1998 witnessed a decrease for the first time in 13 years. The ESCWA region is trying to catch up with the developing world in terms of FDI flows as it still rates poorly with other countries. This is evident from the fact that China attracted almost $40 billion from FDI flows in 1999 whereas the ESCWA region has attracted only slightly more than $7 billion in the same year. Some people may reason that the disturbing political situation is degrading the growth of FDI in certain countries within the region but this cannot be an excuse for all countries, some of which are among the wealthiest nations in the world and are yet, far below their expected share of FDI inflow.

Egypt had attracted the second highest amount of FDI in 1999 (after Saudi Arabia). Inflow of FDI into Egypt reached $1.1 billion from $1 billion in 1998, which was much higher than the 1997 value of $888 million. This gives Egypt a five years' average of $994 million, which is impressive by ESCWA standards. The FDI inflow in Egypt is directed to sectors like chemicals, metal, textiles, the silver industry, and also tourism which brings large amounts of revenue to the Egyptian government.

In the Asian context, FDI flow is expected to climb high in Asia in the coming years although the FDI flow into Asia will drop in 2001 to $123.1 billion due to the economic slowdown. However, it is expected to continue to grow to $170.7 billion in 2005 from $141 billion invested in the region in the year 2000, caused by a wave of M&A activity[2].

Despite the expected decline in Asia's FDI flow in 2001, it is most likely that the ESCWA region will gain a higher percentage of FDI flows in 2001. This is primarily because certain governments have recently adopted policies that make it possible for foreign investors to establish businesses connected to the global market.

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1. The ongoing Palestine – Israel conflict, the US-British air-strikes against Iraq, the Bahrain-Qatar border conflict and the US navy mishap in Yemen are still major concerns for prospective investors .

2. The Economists Intelligence Unit (Biz Asia) February 2001.

Dubai, an emirate of the UAE, has established a $250 million dollar Internet city (DIC) with world-class infrastructure allowing 100% ownership, 50-year renewable land leases and tax-free environment with high standard regulations, which is a major technological advancement for the whole region [1]. This has attracted numerous companies including 200 top American establishments. Bahrain, which attracted $300 million in the year 1999, has managed to convince Chevron and Coca-Cola to move their regional headquarters from London to Manama.

In Jordan, the FDI inflow have halved from its 1997 peak levels of $360 billion. However, despite the dismal FDI performance in the past 3 years, Jordan is managing to pick up again as a result of the ongoing privatization program and due to the Jordanian government's success in joining the WTO and the free-trade agreement with USA. This has helped attract a large number of high-tech companies from the USA to join partnerships with Jordan and in the development of the economic zone in Aqaba [2]. Unfortunately, Jordan hasn't taken advantage of these flows in investment to reduce the high unemployment rates in the country [3].

Qatar – a country of tiny geographical size and low population, which doesn't exceed 750,000, has been unsuccessful in attracting high volumes of FDI inflow during the past few years. Its highest level of FDI inflow remains a record of $132 billion in 1994, which has halved presently. But with Qatar preparing to be the world's leading producer of clean fuels, using Gas To Liquid (GTL) Technology [4], the FDI flow in the country could be revived to world standards.

Saudi Arabia, the largest country in the ESCWA region in attracting FDI inflows, is likely to lead the path in increasing FDI flows in the coming years. While it has maintained its $4 billion flows in the past two consecutive years, the volume is likely to reach new records in the coming year due to the implementation of major economic changes, which will be elaborated in the next section.

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1. "The technology advancement, especially in information, telecommunication and genetics engineering, is one of the most powerful challenges that face the Arab countries." – Dr. Ahmed Joylee, Secretary General of the Arab Union council.

2. Effective, January 2001, Jordan has established a special economic zone at Aqaba where corporate taxation will not exceed 5%, retail tax less than 7% and service tax not to exceed 5%.

3. The unemployment rate among the fresh graduates will reach 60% in Jordan by end of 2001.

4. The ultra clean fuels produced with GTL Technology offers the potential for significant cost-savings in comparison with fuels manufactured from crude oil by conventional refining methods.

4.1 Outlook for FDI In The Region

The ESCWA region has been a region of great importance since a long time and more so after the discovery of vast petroleum and gas resources in the region. The importance of the oil and gas sector to the ESCWA region is clearly visible in the economic stratagem employed in these nations and is even more evident in the foreign direct investment flows to the region.

Saudi Arabia has opened the door for foreign investments in its upstream gas sector for the first time as the result of an official meeting, which was held last June in Riyadh with the executives of the top eight energy companies worldwide [(1)]. Recently, Saudi Arabia also took serious steps to invite FDIs in its power generation and petrochemical industries, which require an estimated investment of $200 billion over the next 20 years.

At the end of last April, 130 foreign companies had been granted licenses by a new government organization, (SAGIA)[(2)], covering investments worth $10 billion. In May, another 93 companies were added to that list brining investments of $366 million (For more details, see Gulf Business, July 2001). Saudi Arabia has also granted 82 licenses for foreign investments worth $30 billion riyal (Approximately $8 billion) to be invested over a span of 15 months. At this moment, Saudi Arabia has 41 licensed industrial investment projects worth 16 billion riyal (Approximately $4.26 billion) and 41 non-industrial projects worth 14 billion (Approximately $3.73 billion) riyal in the pipeline.

Monitoring and analyzing few aspects of the FDIs in Saudi Arabia will reveal that:-

- Despite the presence of local partners in recently licensed projects, the majority of the shares belong to foreign partners who own 82.8% of the total investment and 99% in the case of non-industrial projects.

- Seven of the industrial projects covered 93.6% of the investments whereas the rest was distributed among the remaining projects. A heavy concentration of the investments targeted the non-industrial projects where a single project totaled 13 billion riyal (Approximately $3.46 billion) from14.2 billion riyal (Approximately $3.78 billion). This project was implemented in the educational sector by American firms.

- It is noticeable on analysis that most American companies do not invest outside the industrial sector, although the long and strong relations between the two parties remain undisturbed.

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1. In June 2001, executives from (ExxonMobil, Royal Dutch/Shell, BP, Phillips, Occidental, Marathon, Conoco and TotalFinaElf) met in Riyadh and agreed to develop three huge new gas fields across Saudi Arabia - *Total value $25 billion* (Gulf Business, issue 6, July 2001).

2. SAGIA - Saudi Arabian General Investment Authority.

On further analysis, we can clearly analyze the impact of the FDI trend on major businessmen and decision-makers in the kingdom. However, this is not supported by written data but is based on our extensive research on the topic:

- Business men are generally reluctant to be involved in partnerships with foreign companies, as they believe that foreign firms, after understanding the domestic market environment, will breakaway for further development in the form of private firms.

- Top businessmen in the region have built their fortunes and enterprises from scratch. They are generally interested in becoming dealers or agents for the foreign companies' products rather than entering into strategic partnerships with them. This is primarily to serve their intention of gaining technological know-how.

This could be a reason for the lack of cooperation between private Saudi firms and foreign establishments. Even after the recent easing of rules and regulations [1] in the kingdom, positive developments still tend to occur, predominantly, between the Saudi government and foreign firms.

In Syria, the government, with its new president - Bashar Al Asad, has announced plans to encourage foreign investments flow to the country, which still remains within the $100 million level. Major steps in the financial sector and in opening trade borders with Iraq and other countries will help to increase the FDI flow in the country. Recently, the government announced plans to establish a technology city in Syria and has allocated adequate resources including 10,000 hectares of land and $6 billion for the project. The Syrian government is also looking to attract venture capitalist investments in the area to enhance the countries IT, communication and networking infrastructure and to improve the reigning administrative infrastructure in Syria[2].

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1. The government has granted foreign investors 100% ownership.

2. See Business.com (Magazine), July 2001

4.2 Factors Controlling FDI

Direct foreign Investments are influenced, directly or indirectly, by various social, economical and political factors. These factors include profitability, infrastructure, socio-economic situation, political situation, taxation, law and availability and affordability of manpower. In the ESCWA countries, the major influencing factors of FDI flow are as follows:

4.2.1 Economic Situation

The incessant availability of oil has achieved remarkable economic growth and success in six of the ESCWA states, namely the GCC countries. These states have witnessed a 22.6% growth rate in their economies after their GDPs skyrocketed from $225 billion to $312.8 billion [1]. (See Table 1 for more details)

The Arab individual's average share of the total GDP rose from $2277 in 1999 to $2203 in 1998, an increase of 3.4%. This share varies among the ESCWA countries where it is $13,000 in UAE and Kuwait, $9958 in Bahrain, $6724 in Saudi Arabia and Oman, $4676 in Lebanon and Iraq, $1633 in Egypt, Syria, Jordan and less than $500 in Yemen[2].

Table 1: GDP - 2000 Performance For ESCWA Region

Country	GDP ($ Million)	GDP Per Capital ($)	GDP Growth (%)
Bahrain	6,866	9,809	4.0
Egypt	87,300	1,311	2.8
Jordan	8,340	1,668	3.0
Kuwait	37,704	17,138	5.1
Lebanon	16,600	4,486	0.3
Oman	15,818	6,327	4.6
Qatar	14,633	24,388	7.5
Saudi Arabia	173,000	7,621	4.5
Syria	19,380	1,204	3.2
UAE	60,700	19,581	6.0
Yemen	6,769	398	6.5

Source: MEED Magazine. Vol. 45 No 29

1. Bayan Newspaper - August 20, 2001.

2.The Economic Arab Union Report, September 2000, Page 22.

However, in the UAE, the government is attempting to diversify its sources of income to decrease its dependence on oil-related industries. As a part of the ongoing efforts, it has focused on the tourism sector and has thereby constructed luxury hotels, entertainment facilities and publicized them through the print and electronic media. Burj Al Arab, the tallest hotel in the world, is a result of the UAE government's single-minded dedication to improve the tourism industry in the nation. Another big project is the Palm Island project, which promises to be a landmark on the global tourism map. However, latest reports show the share of expatriate population in UAE to have reached a record of 75%(1), which translates into a much higher share in the workforce. This has an impact not only on the economical front, but also brings in associated social implications, which could be a matter of grave concern for the nation.

Qatar has also followed in the footsteps of the UAE and has taken long-term steps to increase the FDI flow into Qatar. Over the past two years, the GDP has increased by 35% resulting in prosperous economic development and growth. Exports have also increased by 60%(2) and for the first time in 10 years, Qatar has been able to achieve a surplus of $1 billion.

In Oman, the investments continue to flood the gas and petroleum sector. In addition, the government has started privatizing many of its institutions and intends to privatize Seeb and Salalah airports. Oman also possesses the maximum potential to develop its tourism industry, as it is the most eco-diverse in the ESCWA region. However, foreign investors remain concerned about certain stringent rules in the country(3).

After the end of the border conflict with Qatar, Bahrain has perceptibly increased its investments in aluminum refinery and oil refinery projects. Bahrain also has a small but growing tourism industry catering predominantly to tourists from the GCC countries.

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1. See ' Journal of the Emirates Industrial Bank' - July 2001.

2. Al Bayan Newspaper – August 20, 2001.

3. "The Mandatory 51 percent Omani stake in joint venture projects is seen as an imposing barrier to the security of overseas capital" - Mobius On Emerging Markets, P14 - 1995

4.2.2 Political Situation

Political tensions have generally risen in the first nine months of 2001 with the ESWCA member, Palestine, and its economy being the main casualty in this political crisis.

With more than $2 billion in economic losses, 35% unemployment, $100 million budget deficit and being under occupation for 45 years - the subject of attracting FDIs to Palestine, in the near future, seems to be far fetched.

Iraq, the other member of the ESWCA region remains under UN sanctions for the eleventh year. Nevertheless, the tension appears to be abiding with the implementation of a changed Iraqi foreign policy towards certain Arab countries and expansion of trading zones, which has caused the Iraq – Syria free trading to reach the one billion dollar mark. Egypt and Lebanon have also established free trading regulations with Iraq, which is a positive sign for intra-ESCWA trading.

Insurance cover provided for investments in the Middle East, protecting it from losses due to unexpected changes in the political climate, may also improve investor confidence. Investment inducing measures such as these might drastically change the FDI scenario in the region. However, the ESCWA has, so far, neglected its political influence in inducing worldwide economical changes to its favor, like the Euro currency creation.[(2)]

4.2.3 Manpower And Labor

Foreign Investment Companies tend to favor regions with low labor costs and cheap manpower. Unfortunately, Arab countries cannot compete with the labor costs in developing countries, which therefore attract a larger number of FDIs. This has resulted in widespread unemployment among the Arab youth, especially fresh graduates lacking experience.

According to the Arab Labor Organization, the Arab markets receive 2.5 million employees each year and this figure is expected to be 3 million in five years. The present manpower population is 89 million and expected to be 123 million by 2010. The unemployment rate prevalent currently is 14% and that gives us 12.5 million unemployed people[(3)].

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1. UNCTAD World Investment Report 2000.

2. Dr. Faris Gerdai, Effect OF Euro on Arab economies, Arab monetary fund, June 2000, p: 277

3. Al Sharaq Al Awsat Newspaper - 20 August 2001

To address the growing unemployment problem, new labor laws have been put into practice which direct foreign and national organizations to implement a percentage national employee scheme (especially in important sectors such as banking, gas and oil). Although it opposes the non-discriminatory regulations of foreign establishments, governments need to apply this mandatory scheme to reduce unemployment rates in the region.

4.3 FDI Inflow In Developing Countries (1)

As opposed to economist opinions, the FDI inflow to the East and South-Asia increased by 11% to reach $93 billion in 1999. Most of the new inflow went to industrializing economies like Hong Kong, China, Korea and Singapore whose inflows increased by 70%.

In Korea, FDI inflows attained an impressive record of $10 billion, whereas in Singapore and Taiwan FDIs recovered from a decline in 1998. Hong Kong (China) was the second largest recipient of FDI inflows in the region after it increased the inflows by 50% to reach $23 billion in 1999. This leap came as a result of the huge efforts Hong Kong (China) had done in getting back many funds owned by local investors and foreign investors based in Honk Kong in addition to reinvesting large amounts of earnings.

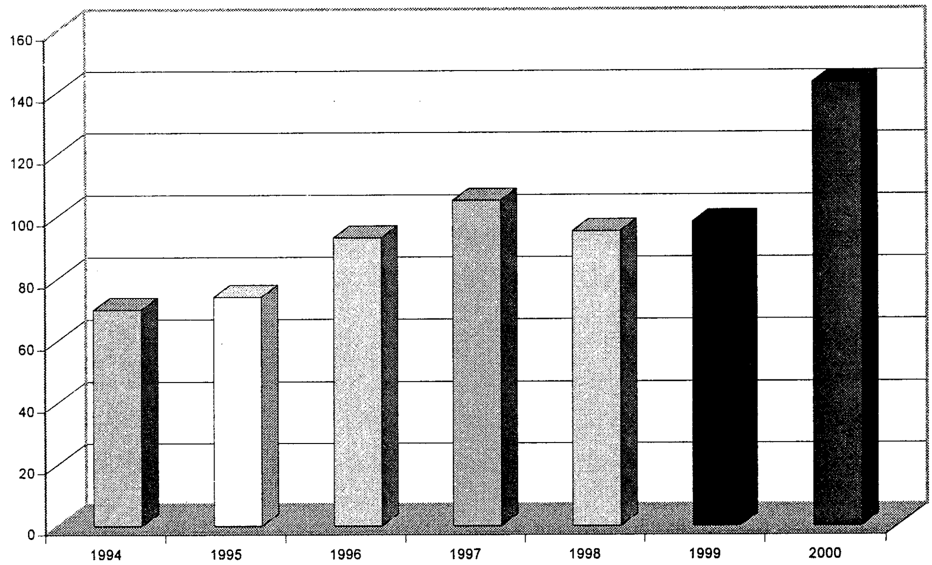
In South-Asia, inflows declined by 13% in 1999 to $3.2 billion. India was the largest nation to receive FDI inflows, which reached $2.2 billion, a decline of 17%. As for Central Asia, FDI declined in 1999 to $2.8 billion. The Pacific Island economies saw an increase to its FDI inflow, reaching $250 million. However, FDI flows to West Asia increased to $6.7 billion, with Saudi Arabia receiving most of the new investments.

In other parts of the developing world, the FDI inflow in Latin America and Caribbean increased in 1999 to $90 billion, up 23% over 1998. Brazil sustained its leadership in receiving the biggest share for the fourth consecutive year by gaining $31 billion most of which went to non-tradable services and domestic market manufacturing. Argentina tripled its share to $23 billion and Mexico received $11 billion in 1999.

A significant part of the FDI inflow to Latin America came through M&As, which valued $37 billion in 1999.In this, $16 billion were transacted through the acquiring of domestic companies by foreign ones.

In the year 2000, FDI inflow to developing Asia reached $141 billion, which implied a 44% increase over 1999. This increase primarily resulted from the FDI increase in Hong Kong and China. Table 2 (next page) below shows the FDI inflow to developing Asia between 1994 and 2000 (all figures in Billion US$):

Table 2. FDI Inflow To Developing Asia, 1994 - 2000



Source: UNCTAD World Investment Report 2000

5. Possible Methods Of Attracting FDI Flows To The ESCWA Region

The socio-economic interests of the host economy and the financial interest of the foreign investors primarily govern FDI flow into a market, which can be implemented through various methods. However, in the context of the host economy, the advantages and disadvantages of a particular mode of FDI flow vary according to the different economic and social factors existing in that economy.

Recently, two major ESCWA countries were downgraded by Moody's and S&P - Egypt(1), which is the second largest within the ESCWA region in attracting FDI flows, was downgraded by Moody's and S&P (2). Lebanon was downgraded by Moody's, which coincided with the release of an IMF report encouraging the government to tighten its fiscal stance in the second half of 2001,to approve value-added tax and telecom laws and progress towards a private and primary surplus (3).

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1. These two agencies rate Egypt BBB-, the lowest level of investment grade. (Meed – 20th July 2001)
2. Moody's stated on the 6th of July 2001 that its rating for Egypt is supported by the countries modest external debt service, the progress made in giving the private sector a larger role in the economy and the prospects for development of newly discovered gas reserve. However, the agency says it is concerned about several negative policy developments, in particular the growth of the domestic public sector debt burden and the weakening fiscal position. (Meed – 20th July 2001)
3. Lebanon's foreign currency debt rating has decreased from B1 to B2 and the same for its foreign currency –denominated Eurobonds and the governments domestic currency issuer rating to B3 from B1. (Meed – 10th August 2001)

This should give us a general view of the economic situation in the region and in this lies the potential of foreign investments to enhance and improve the prevailing economic situation so that the ESCWA region is at par with first world economic standards

In this section, we shall try to identify and judge the quality of each method of attracting FDI flows to the ESCWA region. These methods are:

- Mergers and Acquisitions – Despite worldwide success in increasing FDI flows, M&As are not popular in the ESCWA region as the markets lack depth and size. Besides this, family businesses control approximately 85% of the total business companies in the GCC alone, which leaves little scope for M&As.

- Free Trade Zones – A potential method of bringing in FDI to the ESCWA region due to high government patronage and clear-cut benefits including technology transfer and increased employment opportunities.

- Capital Markets – Could be a beneficial method of FDI entry provided respective governments have controlled indexes, but as most of the ESCWA stock markets are closed to foreign fund and have small-sized markets and low trade volumes, this method is not expected to carry a lot of promise in the near future.

- Privatization – An already applied method, assured benefits provided proper filtration of foreign investments takes place. A few steps toward privatization are going on in the region, which might be a valuable way for FDI attraction.

Now let's look at these options with a broader view: -

5.1 Mergers and Acquisitions

In today's economy, speed is an essential pre-requisite for the business environment and this fact has been the major cause for the recent wave of cross border mergers and acquisitions all over the world. M&As act as a mode of FDI flow providing speed and proprietary assets. Global M&As are the quickest ways of gaining a sound footing in a new market, for gaining market dominance and for later expansion.

This sudden spate of M&As have been associated with a consequent increase in FDI flows with global FDI outflows reaching $800 billion in 1999, an increase of over 16% over the previous year (1).

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1. See UNCTAD World Investment Report 2000 for further information on the relationship between M&As and international FDI flow.

Cross border M&As involve large sums of money and major corporate restructuring and therefore represent the most evident signs of globalization. However, globalization in developing countries has tended to raise questions about the negative impact of the cost-benefit for host countries. This is mainly due to the fact that Transnational Corporations (TNCs) have been seen to benefit disproportionately through M&As while local enterprises have been affected adversely and this general trend is clearly visible even in the ESCWA region.

The importance of M&As as the primary source of FDI flow in the ESCWA region is debatable and the rationale for the concern of host countries in encouraging M&As can be illuminated through the following.

- At the heart of these concerns is that foreign acquisitions do not supplement productive capacity but only imply a transfer of control and ownership from domestic to foreign hands. This could also lead to the takeover of certain key sectors such as banking by global oligopolists.

- In the ESCWA region, M&A operations are still far behind in terms of size and volume (see table 3) to compete with world standards and to reach global FDI attraction levels. However, FDI generation through M&As are not expected to bring in major changes in the economic environment in the ESCWA region in the foreseeable future, yet they could contribute to minor improvements in FDI flow and economic development.

Some recent improvements have been happening within the ESCWA institutions themselves, like the merge of banking and investment units for the Saudi Dallah Albaraka Group (DBG) with Kuwaiti firm, The International Investor (TII), to create one of the largest Islamic banking entities(1) and the Kuwaiti Finance House's steps to acquire 20% of The National Bank of Sharjah. (2)

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1. On the 6th of June 2001, a memorandum of understanding was reached for the merger. DBG has stakes ranging from 50-100 percent in Islamic banking units which will be merged under TII. DBG will own 35 percent of the new entity. TII will pay for the banking units in cash and stock worth over $300 million.

2. In May 2001, Kuwait Finance House (KFH) became a major shareholder in National bank of Sharjah (NBS) following its decision to acquire a 10 per cent stake. NBS will have two members from the KFH on its board. The shares were acquired at US$2.1 per share.

Table 3. Biggest M&As In the GCC During The Nineties

Institutions	Country	Value ($ billion)	Status
Aramco & Smarc	Saudi	-	1993
The Saudi Electrical Company	Saudi	9.0	1999
Bahrain Ahli Bank & Kuwait Union Bank	Bahrain / Kuwait	0.5	Expected
The Saudi – European Bank (3 Saudi Banks + 3 Gulf banks)	Saudi	7.0	Suggested

Source: Volume 15, Number 3 of "Journal of the Emirates Industrial Bank".

Yet, all M&As do not make a favorable impact on host-country development as most often than not, the commercial objectives of TNCs and the development objectives of host economies do not coincide.

- Though FDI through M&As bring in adequate financial gains, these financial resources do not always go into the capital stock for production, which is again detrimental to host –economy development. M&As also do not aid technology transfer and upgradation, at least at the time of flow into the host economy and do not change the unemployment scenario in the country, as there is no addition to productive capacity.

Thus, the irregularity of M&As in providing the host economy with the benefits associated with FDIs has caused the member countries of the ESCWA to explore alternative methods of attracting FDIs, especially in the forms of Free Trade Zones, which will be explained explicitly in the next section.

5.2 Free Trade Zones

Over the past decade, free trade zones have sprung up all over the ESCWA region in a bid to attract FDI flows and they have been successful in doing so by becoming an important point of consideration for foreign investors entering the ESCWA region. At a macro level, the governments have stood by their faith in the free trade zone strategy to eliminate over dependence on oil-related industries and to diversify sources of national income through FDIs.

The original cause for the creation of free zones in the ESCWA region had been to improve the infrastructure at ports. However, free zones have now become the supreme method for economic diversification in the ESCWA region. The wide popularity of free zones arises from the fact that they allow foreign investors, both Western and Asian, to totally control their investments and profits. These FDIs then reciprocate by handsomely contributing to economic development in the region of their inception.

Further positive economic policies have spurred on healthy competition among the existing and emerging free trade zones and have thus contributed to an evident rise in FDI flow. The inter-regional and intra-regional competition among the free trade zones is on the rise with Bahrain the latest to join the bandwagon.

5.2.1 Free Trade Zones in UAE

The free trade zone strategy has been especially successful in UAE where there are ten currently operating free trade zones of various shades. With increased intra-regional competition, each of these free zones are striving to best suit foreign investments by cutting on rentals and peripheral services.

Free zones are being developed in a bid to attract foreign investment and the governments are providing adequate infra-structural support including advanced technology, lower rent costs and tax-free imported components to facilitate the functioning and growth of these companies. Amidst the fierce competition, Jebel Ali is clearly in the lead, which is evident from the fact that Daimler Chrysler has opened its latest 55,000 stock keeping warehouse there in March 2001.

Despite Jebel Ali's standing since its creation in 1985, the smaller free trade zones have also fared well with the rest of the free trade zones, except Jebel Ali, operating 1500 companies among them. Jebel Ali has over 1900 firms to itself.

Ajman is home to the second largest free trade zone in UAE with the Ajman Free Trade Zone housing nearly 600 companies. Manufacturing is the dominant sector here, with plans to establish an IT park already underway.

Fujairah has also diversified its traditional role as an East Coast port with the opening of the Fujairah Free Trade Zone, which is home to 138 companies. Its ideal location as a passage through the Strait of Hormuz has played a role in its development into a manufacturing hub.

Sharjah also possesses 2 important free trade zones – the Saif airport zone and the Hamriya seaport zone. The Saif free zone houses 400 companies and is considered to be the leader among airport zones whereas the Hamriya free zone accommodates only 100 companies. However, the Hamriya free zone is expected to grow with the development of the inner harbour at Sharjah.

Abu Dhabi too has plans in place for the construction of a free zone situated on the 3500-Hectare Saadiyat Island. This free zone has a major difference in the fact that it is not in proximity of a seaport or airport.

The last entrant into the free zone market has been the Ras Al Khaimah Free Trade Zone, which, after it's completion last summer has, attracted 32 establishments into the region. The cost factors at Ras Al Khaimah have aided its quick development so far.

5.2.2 Free Trade Zones in Kuwait

Kuwait has also recently recognized the usefulness of free trade zones and has established the 300,000 sq. meters Kuwait Free Trade Zone (KFTZ) in the commercial port of Shuwaikh, which offers excellent access to regional markets in the ESCWA region[1]. Promotional measures such as waiving of dock fee and streamlining of procedures have played a supportive role in the growth of KFTZ.

Kuwait is also dabbling with the concept of a "Future Zone" aimed at attracting new economy establishments and the government is also studying the possibility of turning the whole of Kuwait into a free trade zone.

5.2.3 Free Trade Zones in other ESCWA Countries

Bahrain has been the latest ESCWA country to enter the free zone market [2] and is already developing a niche of its own in the market and is quickly moving ahead on the fast track of development.

Egypt has been registering steady progress in its free trade zones, which contain 851 registered companies with a capital of \$6 billion and an investment cost of \$17 billion. These free zones in Egypt offer 82,000 job opportunities (Bayan-16/8/2001), thus generating employment, which is another additional benefit common to all free trade zones.

However the global lifetime of free trade zones may be limited as more and more countries open up their markets and liberalize trade rules. Yet these free trade zones in the ESCWA region could be continually successful in bringing in FDI flows if they focus on niche products and services.

5.3 Capital Markets

Capital markets are yet another method of attracting foreign investments in the ESCWA region. The functioning capability of capital markets depends essentially on how fast an investor can move his capital in or out of the host economy.

After the 1997 Asian crisis, governments have been worried about FDI portfolio investments and hence they have encouraged direct investments instead, which include infrastructure projects. Due to this reason, some countries are willing to receive only FDI portfolio investments and they tend to control them by regulations.

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1. In a span of 18 months, the KFTZ has roped in 130 firms and has declared additional plans to expand operations.
2. On the 10th of May, Bahrain announced the creation of a free zone. See (Gulf Business, p522, June 2001).

In the ESCWA region, the liquidity of the stock markets varies from one country to another, though mainly, they are small sized with low volume trading. Certain countries like Egypt, Bahrain and Lebanon have encouraged FDI flows to their stock markets whereas other countries like Saudi Arabia and Iraq have totally shunned them. However, in Kuwait and UAE, they encourage FDI flows only through funds and not through direct participation in investments. This step has been taken to keep inward and outward FDI flow under control.

A closer look at the ESCWA countries' stock markets will reveal that those countries that have opened their stock markets to foreign investment flows are not performing well. Bahrain's index, for example, has decreased by 4.5% Y.T.D and the Egypt Hermes Index continues its poor performance(1) as the political tension in the area degrades although the foreign investment performance has shown signs of improvement lately. This improvement seems to be a direct impact of increased "Buying" operations coupled with reduced "Sell" operations. The value of shares traded by the foreign investors accounted to 520.5 million Egyptian pound (Approximately $122.18 million) and the number of foreign investment deals increased by 8.7%, from 5653 buying deals and 5193 selling deals. (2)

In Kuwait, the government has ensured that funds are the only means of FDI flows to the Country's stock market (see table 4). The Kuwaiti index has improved 33.3% YTD and had broken the 1800 barrier when it closed trading on August 25, 2001. (Bayan Newspaper August 26, 2001)

In UAE, foreign investors are not allowed to invest in the stock markets except in one company (EMMAR), which does not provide sufficient scope for prominent profits due to the humble size of the trading in EMMAR shares. Nevertheless, HSBC financial Services and The National Bank of Abu Dhabi arranged a recent bond issue - The Emirates Airlines bonds were launched on 13th June to institutional and professional investors with a minimum subscription level of AED 5 million (Approximately $1,362 million). It is the largest Dirham-denominated bond to be issued to date, and the first to be listed on the Dubai Financial Market (DFM). Emirates Airlines is the first corporation in the UAE to raise finance directly from investors in this manner, which raises hopes that this will open the doors for other institutions to adopt the bonds' release method. This also adds another potentially vital money tool in the market. However, the Emirates Airlines bond issue could have been even more successful if it had been open to foreign investors as well. This would have improved foreign investor awareness and would have also pushed the price higher.

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1. The Hermes index has declined by more than 15% Y.T.D (as of August 16, 2001)

2. See Al Bayan – UAE. Newspaper August 26, 2001.

The Saudi Arabian market continued its bullish trend despite the traditionally slow summer season and the index reached an all–time high of 2558 (as of 18th of August 2001). The central reasons for the upswing were the recently announced economic reforms in the kingdom such as reduction in customs duties on imports to five percent and a multi – billion dollar gas development project signed between eight major oil companies. This left the Y.O.Y index ratio at 18% as the index stands for 8% Y.T.D.

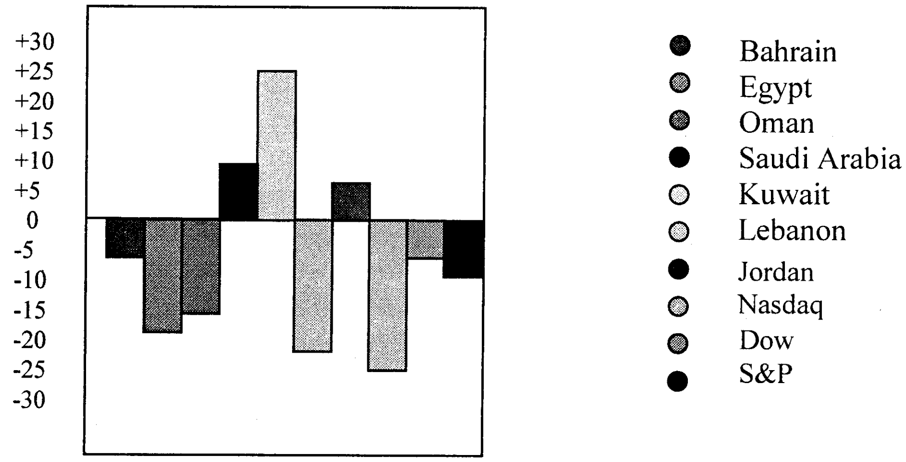

Table 4. Stock Markets' performance Y.T.D as of end of June 2001

The Lebanese market, the second worst performer within the ESCWA region in Y.O.Y performance, has attained a dismal record of –20.97%. The consequences of the South Lebanon and Israeli border struggles are certain to keep the FDI portfolio flows away in the near future.

Oman's market continues to struggle, with an almost 2.5 billion-dollar market cap. Index, its performance is down to –21.3% Y.O.Y and Y.T.D of – 17.6%. The market with its new five-year low has poor investor confidence.

The other factor that does not exist in the ESCWA countries' stock markets is transparency. There are neither terms nor regulations that oblige the listed companies from disclosing their financial results quarterly. In contrast, the listed US companies disclose their earnings quarterly and the results of these companies have a strong impact on the stock markets performance. A leading company's results might lead to the improvement of the performance of the whole sector that it belongs to. In addition, transparency makes both companies and investors aware of the current trend in the whole sectors. This will help in identifying weaknesses and provoke the officials to find solutions. With regard to the ESCWA region, this implies that the governments can exactly understand what sectors need to be concentrated on in order to strengthen their economies.

Overall, we have seen minute, sporadic improvements in the region [1]. Taking them all into consideration, there has been a noticeable improvement over a short period of time, but still a lot more needs to be achieved.

5.4 Privatization

The primary objectives of any privatization plan is to generate higher productivity and faster (but sustainable) growth, and as a consequence increase returns on assets and equity while at the same time raising internal efficiency, improving capital structure and increasing capital expenditure.

The past few years have witnessed an unprecedented rise in privatization in some parts of the ESCWA region with countries realizing the acute need for a more liberal economic structure due to the lack of investor confidence in the region. The governments have tried to incorporate certain positive modifications in their economic policy and have compromised on certain regulations that have been strictly rejected until now.

The recent privatization spree has sparked a rise in FDI growth and has successfully complemented the role played by free trade zones in wooing foreign investors into the region. Privatization is definitely the topic of the moment.

Saudi Arabia, the largest ESCWA country in attracting FDI, has been no exception to the ongoing privatization drive and there are evident signs that the world's largest oil producer is moving toward selling off some of its assets. Last year, the Saudi government established the Supreme Economic Council, introduced a new foreign investment law and created the Saudi Arabian Investment Authority as part of its privatization plans.

A key area of opening up to privatization has been the power generation sector which is moving towards being a highly competitive private market. The government also intends to privatize the national airliner, Saudia, [2] which ranked 23rd in the region in terms of passengers transported in the year 2000. Although the oil industry is not yet open to the private sector, ARAMCO's monopoly has come to an end with foreign companies being involved in the exploitation of natural gas.

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1. Implementation of the Arab Financial Markets Network will link all Arab stock markets electronically and enable trading online. The restart of the Kuwait secondary market and the U.A.E stocks markets (Abu Dhabi, Dubai) linked electronically together furthers efforts in adding new market instruments. Efforts in establishing a new stock market for the republic of Syria are underway along with a couple of other enhancements.

2. The government appointed a BNP-Paribas consortium – comprising SH&E, Gulf Investment Corporation in partnership with Gulf International Bank and KPMG Consulting as the sole financial advisor for Saudi Arabian Airlines, Saudi's, privatization program. (Arabies Trends – April 2000).

The Saudi population grows at a rate of over 3% a year and this simply means that the Saudi population will double in the next 10 years. The Saudi government has foreseen the impending increases in demands in all sectors and therefore the privatization drive has been seen as a solution to avert the possible economic turmoil.

In short, Saudi Arabia has started its journey towards privatization for assured future benefits, which will have positive implications on its prospective economic health.

The UAE has implemented a mixed bag of economic policies with Abu Dhabi surging ahead with privatization and the other Emirates ignoring the possibility of privatization. Fujairah is the only other emirate to have explored the idea of privatization in water and desalination projects, however this too is primarily backed by an Abu Dhabi based organization, UAE Offsets Group (UOG).

In contrast to the antics of Abu Dhabi, Dubai has decided to hold on to its government ownership of key sectors with companies like Dubai Aluminum and Emirates Airlines being wholly state owned. Privatization is a result of lack of capital and expertise which are abundant in the UAE, hence it is a surprise that privatization has really failed to grow in stature here.

In spite of repeated attempts by various governments, privatization is yet to take off in Lebanon, which hasn't privatized a single state run service to date. However, privatization has been identified as a method of rescuing Lebanon from its ongoing fiscal crisis but the advent of privatization, as mentioned earlier, is yet to begin.

With oil wells running dry, Oman has turned towards privatization to build its economic diversity and an exemplary project of this recent change has been the Salalah Free Zone Company, in which an American company has a 20% holding and Hilwood Strategic services - 40%. The government is particularly interested in large foreign establishments who can get projects off the ground in short time. The government also intends to privatize the Seeb and Salah airports, the implementation of which is bound to increase the quality of service provided to both, planes and passengers. [(1)]

Privatization in Jordan had been more of a circumstance-driven phenomenon in the past and it has been only since King Abdullah's(II) reign that the government has seemed genuinely committed to the process. The government has since then gone on a privatization spree and has privatized almost everything from water to telecom. Airliner Royal Jordanian and the energy sector are also on the privatization list along with various other sectors of the Jordanian economy. The government has fared well in dealing with privatization related issues but is yet to convince the population about its related benefits.

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1. Oman will forge, before the end of 2001, a new mining law that would facilitate investments in various mining sectors. The new legislation would permit foreign firms to invest in mining for copper, gold, chromium, silver, iron and magnesium

The good start to privatization in the second largest ESCWA FDI attraction (Egypt) has seemed to slow down within the recent years. No major privatization accord has taken place during the last two years and out of more than 300 institutions on paper, less than half have been completed (see table 5).

Nevertheless, Privatization remains the cornerstone of the government in Egypt. It involves many organizations like the Ministry of Public Enterprise, the Ministerial Privatization Committee, the Public Enterprise Office, the Quattro Committee, the Capital Market Authority, the Holding Companies and the Share Pricing Committee..

Table 5. Privatization in Egypt

(Billion Egyptian Pound)*

Method	Number of Companies	Amount Raised
Public Offerings on the Cairo and Alexandria Stock Exchange	38	5.7
Sale to Anchor and Strategic Investors	26	6.7
Employee Stock Ownership Programs	30	0.870
Liquidations	32	-
Total	**126**	**13.27**

Source: Carana Corporation's Quarterly Review of April – June 2001.
* 1US$ = 4.26 Egyptian pounds

In the context of the ESCWA region, privatization is going to be an eminent feature of the forthcoming decade, regardless of existing government policies and ideals. This trend is undoubtedly going to bring in FDI in to the ESCWA region and faster implementation of positive economic policies by the various governments will make a discernible difference in the future economical standings of the ESCWA countries. Therefore, the ESCWA countries will do well to exploit the potential of privatization, in enhancing their economic development.

6. Recommendations:

Keeping in view, the various developments and continuously changing trade environment, the following recommendations have been drafted to improve the FDI flows in the ESCWA region and to gain maximum benefit from the flows for economical improvement. Therefore, these suggestions could be used by the concerned governments of the ESCWA for the installation of FDI promoting activities in their economical strategies:

6.1 Recommendations for ESCWA's Governments.

1. Governments should reduce corporate taxes, provide longer tax holidays, permit losses incurred during tax holidays to be written off against future profits, accelerate depreciation allowances and reduce social security contributions and corporate income taxes charged against marketing and promotional expenditures.

2. In ESCWA, the respective government investment promotion agencies, should work together to adopt a single format and include the right policies in acquiring, calculating and sharing information.

3. Governments should open their internal markets to foreign investors, to enlarge their market size, which is a primary contention for foreign investors aspiring to invest in the ESCWA region.

4. Another important aspect is the construction of a structured and meaningful public-private sector dialogue to promote a healthy business environment that could further result in the promotion of public-private sector partnerships and the provision of support institutions to enable technology transfer and to create an environment conducive for continuous innovation among local enterprises. The public-private partnerships could then reciprocate by instilling an able business environment, which thus forms a FDI supportive cycle.

5. Six of thirteen ESCWA countries (Major Oil producers) have committed substantial proportions of their oil revenue to provide benefits for their citizens. The overall cost of this commitment has increased sharply in recent years as populations have expanded along with increases in demands on healthcare services and various other public service sectors. Additionally, citizens are reaching retirement ages and are drawing heavy pensions from their employers, including the government, which is proving to be difficult to keep as per the present economic situation and increasing government budgets expenditure, reflecting the overall growth results. The governments must realize that times have changed and should necessarily eliminate futile spending and implement economic restructuring plans, to fit future budget plans and to further economic development in the region.

6. Governments should aim at providing foreign investors with a positive business environment supported by strong macroeconomic policies, a structured and transparent legal and tax system, highly developed physical infrastructure, especially in transport and telecommunications, and skilled labor. These factors should be combined with a stable economical environment with consistency in trade, investment and enterprise development policies to facilitate the initiation, growth and retention of FDI in a state.

6.2 Suggestions to the ESCWA organization

1. **R&D and Data Updating:** Research and development is a part of every economic policy and hence it's hugely important to continuously monitor advances made by the regions' countries in attracting FDIs and to collect relevant data on a monthly or quarterly basis, thus enabling the update of the ESCWA information database.

2. **Employee Training and Information Gathering:** It's necessary to conduct ESCWA workshops for government employees (planning ministries, chamber of commerce, trade ministry, IPAs) to upgrade and enhance their skills in collecting important information and calculating and predicting FDI patterns in the region based on statistics and facts. It would also be a good idea if ESCWA could convince the region to use a united FDI calculation format. Seminars are also to be conducted on topics such as successful FDI attracting practices and to consequently produce a manual on the most successful practices. Intensive research and analysis should also be conducted on certain topics such as the impact of economic incentives and strategies on FDI flows and the impact of WTO commitments of the concerned governments on FDI fitness.

3. **FDI rating Index:** The ESCWA organization could create a credible FDI risk rating index that, besides, giving various countries an idea of their FDI levels, will help them understand their position in world standards in different aspects such as currency convertibility and free repatriation of capital. The index created should be accredited and recognized as a source of reliable data, by all international organizations, importantly the UN and its related bodies, IMF and the World Bank.

4. **Media & Public Awareness:** It's evident that most investors rely on international credit rating agencies to take decisions on their investments. The outlook of these agencies on the ESCWA region is seriously hurting the FDI prospects of the region. Therefore, the ESCWA study, results and analysis, on FDIs should be easily accessible to the masses through the various forms of media to boost public and investor confidence on ESCWA FDI forecasts and data.

5. **Union Investment Promotion agency:** It is also recommended that the ESCWA create representative IPA bodies in each ESCWA country or geographic sector (GCC, Lebanon – Jordan – Syria, Egypt – Palestine – Iraq – Yemen) to regularly monitor FDI flows in the region and to analyze its impact on the economic development of that country. This will make the information gathering process more efficient and detailed.

7. Conclusion:

In the above chapters, we have analyzed and studied FDI flows and its various aspects. From this, we understand that each region has its own national stance on FDI and therefore, its quintessential that each country in the ESCWA decide upon the best mode and method of FDI entry and growth in the nation.

In the next ten years, it is estimated that a capital expenditure of 350 billion dollars will be required for major infrastructure projects in the oil, gas, electricity and water sector. The ESCWA countries may not be able to meet such massive amounts of capital expenditure in all avenues unless the price per barrel averages 27 to 30 dollars during the next decade, which is highly unlikely. ESCWA countries, therefore, require FDI flows to improve their economies by the efficient use of existing resources, by utilizing unused local resources and by absorbing capital from abroad. This will substantially increase the regional output and productivity and also increase the market access of local goods and services for domestic investors through the global production chain

Hence, it is evident that there has to be a necessary increase in FDI flows in the region which can be achieved only after circumventing the various hindrances to FDI development in the region. The first step towards increasing FDI flows is to ensure total government belief in their benefits and to then increase FDI awareness among the masses. This would lay a strong foundation for increasing investor confidence in the ESCWA region.

Free trade zones appear to be a small-scale example of the method in which regulations and rules have to be dealt with in the region. Ever since their inception, free zones have been attracting investor attention and recognition for their infra-structural facilities and commercial incentives. However, it is important that the region obtains maximum leverage in attracting FDIs to the region through free zones, which then subsequently promotes technology transfer and other advantages from highly professional corporations.

ESCWA member countries are also realizing the importance of involving the private sector in the economic cycle. They have begun to encourage the growth of the private sector enterprises and have started programs to privatize state owned business as means of reducing subsidies and thus conserving cash resources.

Egypt leads the region in privatization with Saudi Arabia, UAE, Jordan, Syria and Lebanon having committed themselves to the process of privatization. In addition to reforms on the macro-economic front, these countries are attempting to create an investor-friendly market by reducing direct government involvement in the economy, by supporting free zones and privatization bodies and by encouraging private sector participation in infra-structural reforms to make them more hospitable to foreign investments. However, the governments should be careful in analyzing the impacts of privatization on a sector-to-sector basis and should create an economic structure based on streamlined procedures to speed up transactions and deals in the ESCWA region

Though the global economic situation is slowing down, it is likely that the region will maintain the same or higher levels of FDI flows during fiscal year 2001. There have been increasingly evident indications that international investors are becoming more frequent visitors to the region, which are positive signs for FDI improvement in the region. However, to ensure economic supremacy for the ESCWA region, respective governments and all other concerned officials cannot afford to be complacent and should aim at enhancing and uplifting the ESCWA region to global standards, in terms of FDI flows and otherwise.

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