

Foreign Direct Investment in the United Arab Emirates: A Study on the Main Contributors

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ABSTRACT

Foreign Direct Investment support the development of the host countries and provides opportunities for the Multinational Corporations to geographically diversify their operations into greener pastures and reap better benefits. This study focuses on a few of the most relevant factors that attract FDI into the UAE. It is observed that the inflow of FDI into the UAE is on the increase year-on-year during the last five years. The relevant factors that make the UAE FDI-attractive are the political stability, geocentric location, well-developed infrastructure, stable currency, well developed financial system, the global crowd-pulling event the Expo 2020, and the proactive and investor-friendly policies of the government.

Keywords: Foreign Direct Investment; Infrastructure; Multinational Corporations; Political Stability; United Arab Emirates.

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I. INTRODUCTION

Companies worldwide cross their countries' boundaries to operate in another country to seek further development, profit maximization, cutting cost, and technological advancement, which is known as Foreign Direct Investment (FDI). FDI is an important contributor to the growth and development for both host country and Multinational Corporations (MNCs); hence, most of the open economies formulate policies and invest heavily to attract FDI inflows. FDI has different forms like greenfield investments, joint venture investments, and acquisitions.

Countries around the world work intensively to attract MNCs to start operating in their economy. Some countries have lower labor cost as their competitive advantage, making them more appealing for MNC's to start investing in. Whereas some other countries provide flexible laws to attract FDI to diversify the development of their economies.

United Arab Emirates is one of the GCC countries, which has built its strong and solid name worldwide. United Arab Emirates (UAE) was promulgated in 1971 and consists of seven emirates, which are: Abu Dhabi, Dubai, Sharjah, Ajman, Ras Al Khaimah, Umm Al Quwain, and Fujairah. The official currency in UAE is Emirati Dirhams (AED), which is pegged to the US dollar at 3.6725AED to one US dollar. The population of the UAE is close to 10 million. Although the UAE is considered a young country, it has built a strong image among the world's countries and became an investment pool due to its geocentric special location that connects the countries around the world. The FDI inflows into the UAE increased since 1990. Table 1 gives data on FDI inflows into the UAE for the past five years.

TABLE 1: FOREIGN DIRECT INVESTMENT IN THE UAE

	2015	2016	2017	2018	2019
FDI Inflow (million US\$)	8,550.9	9,604.8	10,354.2	10,385.3	13,787.5
FDI Stock (million US\$)	109,974.9	119,579.6	129,993.9	140,319.2	154,106.6
Number of Greenfield Investments	335	305	333	382	445
Value of Greenfield Investments (million US\$)	8,996	10,089	8,791	11,895	13,557

Source: UNCTAD.

The inflow of FDI and foreign direct portfolio investments during the last five years shows a gradual increase year-on-year. According to the UNCTAD's World Investment Report 2020, the United Arab Emirates saw its inflows of FDI increase by 32% between 2018 and 2019, reaching USD 13.8 billion [1]. In the same period, the stock of FDI reached USD 154 billion. The country's political and economic stability attracts new investors fleeing from less stable countries in the region. The UAE was the largest FDI recipient in West Asia in 2019.

The main objective of this study is to review the main factors contributing to attracting FDI into the UAE during the last five years. The study's findings would help the regulators and other stakeholders formulate appropriate policies and take necessary steps to enhance the UAE's FDI attractiveness further. This paper's remaining parts are organized as follows: Section 2 presents a literature review on FDI. Section 3 states the methodology. Section 4 focuses on analysis and discussions, and Section 5 concludes the paper.

II. LITERATURE REVIEW

FDI benefits both the host country and the MNC; these benefits attract both parties to agree and proceed with FDI. The host country will be able to grow its economy, develop human capital, increase employment, and provide access to expertise, technology, and skills. Whereas the MNC's will be able to cut costs through lower labor costs, will be able to diversify their market through a subsidiary, and will have better savings of taxes and tariffs.

FDI has developed and increased worldwide in the past three decades due to globalization and ease of capital mobility. Researchers had highlighted the importance of FDI on economic growth. Adams identified that FDI contributes to the country's economy by augmentation of domestic capital and enhancing efficiency by transferring technology and knowledge into the country [2]. Moreover, FDI has effects on the stimulation of savings and national investment as the competition between national and foreign companies increased.

The effect of FDI on developing countries is a controversial topic; some researchers had worked on some papers and empirical studies to provide further details and facts on the topic. Elboiashi stated that the magnitude of FDI impact relies highly on the host country: infrastructure development, technology, financial development, and trade openness are all variables that play positive roles in economic growth in host countries [3]. Several factors play a significant influence on investment decisions; the key ones are the location, exchange rate volatility, political stability, infrastructure, financial system, and government's favorable policies.

Political stability and reliability determine the FDI inflows. MNCs prefer a stable government so that their investment is protected. Political instability may be in the form of the government's negative attitude towards MNCs, blockage of fund transfer, currency convertibility, war, bureaucracy, and corruption. The study by Root and Ahmed [4], and Schneider and Frey [5], looking at aggregate investment flows into developing economies, found that political instability significantly affects FDI inflows. The study by Melo and Quinn indicates that corruption has a negative impact on attracting Foreign Direct Investment [6].

The high volatility of the exchange rate of the currency in the host country discourages investment by foreign firms as it increases uncertainty regarding the future economic and business prospects of the host country [7]. The study by Campa examined how exchange rate uncertainty affected FDI, and the study revealed that greater exchange rate uncertainty increased the option for firms to wait until investing in a market, depressing current FDI [8]. Thus, it can be believed that MNCs prefer to do business with those countries with the stable currency so that the profit in the home country currency is not significantly affected by the exchange rate volatility. The location is an important determinant of FDI inflows in the Gulf region and provides stakeholders with opportunities for growth as long as the right procedures are followed to boost growth [9].

In short, the trend in FDI flows differs by region and country. FDI has innumerable effects on host countries' economy, and mostly all countries are trying their level best to attract FDI by one way or the other, but the inflow of FDI

continues to be lopsided, with some countries getting the lion's share and others barely getting any. The UAE has made tremendous efforts to encourage direct investments for accelerating economic growth [10].

III. METHODOLOGY

The main objective of this paper is to review the main contributing factors of FDI in the United Arab Emirates. The paper will critically evaluate a few relevant factors that contributed to the FDI-attractiveness of the UAE. This study is based on secondary data collected from local, regional and international agencies like UAE Government, Central Bank of the UAE, World Economic Forum, International Monetary Fund, Transparency International, World Bank Group, United Nations and various publications of the statistical departments, governments, and the press. The study covers a period of five years, from 2015 to 2019. The collected data are tabulated and analyzed using appropriate analytical tools.

IV. ANALYSIS AND DISCUSSION

A. Political Stability

Political stability plays a significant role in MNC's decision on FDI. Political stability is one of the vital factors that affect FDI worldwide as MNC's prefer countries with political stability to perform their operations smoothly and safely. The United Arab Emirates is a federation of seven emirates: Abu Dhabi, Dubai, Sharjah, Ras Al Khaimah, Ajman, Umm Al Quwain, and Fujairah. The federation was formed and became independent in 1971. The Federal Supreme Council (consisting of the Rulers of the seven Emirates) and the Council of Ministers constitute the executive of the UAE government. The President and the Vice President/Prime Minister are chosen by the Rulers. The Federal Supreme Council ratifies legislation and the appointment of Ministers and Judges of the Federal Supreme Court. The Federal National Council performs a consultative role – considering draft legislation, proposing amendments, questioning Ministers, scrutinizing the executive. It consists of 40 members drawn from across the emirates roughly in proportion to the population. Half of the members from each emirate are appointed by its Ruler. The other half are elected by voters who are designated by the Rulers.

The United Arab Emirates is politically stable, which makes the country a favorable destination for foreign investors. The vision of UAE's leaders encourages FDI into the country through maintaining a stable political environment, diversifying industries to develop the economy, and enforcing legislation that supports FDI in the country. The stability of the UAE's politics is achieved and managed through long-term strategies and vision. The enforcement of laws, standardization of leaders' vision, cooperation between emirates, standardization of systems, government transparency with the national police force, and a security force are all factors that supported the stability of UAE politics. Table 2 gives the political stability ranking of the UAE based on the terrorism and violence measures in

the countries and the practices which involved the government.

TABLE 2: POLITICAL STABILITY RANKING OF UAE

Year	2015	2016	2017	2018	2019
Global Rank	54	64	61	55	54

Source: theglobaleconomy.com.

The global indicator of political stability shows that UAE is maintaining a good position in political stability, during the period of study, the rank was in the range of 54 to 64. To date, there had been no major political unrest in the country, and one does not expect things to go wrong in the near future because of the strong political will and farsightedness of its rulers in formulating strategies for the growth of the country and prosperity of all citizens and residents. Political unrest springs up only when there is discontent among the citizens of the country, and as far as UAE nationals are concerned, most of them are content and happy with plenty of opportunities to fulfill their dreams provided they can put effort to convert their dreams into realities [11]. Hence the international investors can be sure that they will get a warm welcome in the UAE, their funds will not be blocked, enjoy easy convertibility, least bureaucracy bottlenecks, and the lowest corruptions.

A further probe is made into the country risk to judge the attractiveness based on blockage of fund transfer, currency inconvertibility, war, bureaucracy, and corruption. Credendo Group provides business and economic data for 200 countries and has classified country risk under different indicators, where countries are classified into seven categories: from 1 (low risk) to 7 (high risk) [12]. Table 3 gives the ranking of the UAE for the period 2015 to 2019.

TABLE 3: COUNTRY RISK: CREDENDO GROUP INDEX RANKING OF THE UAE – 2015 TO 2019

Year	2015	2016	2017	2018	2019
Transfer risk	2	3	3	3	3
Expropriation risk	2	2	2	2	2
Political violence risk	2	2	3	3	3

Source: Compiled from Credendo Group index reports 2015 to 2019.

The transfer risk, expropriation risk, and political violence risk are very low in the UAE, and the international investors may confidently go ahead with their investment decisions and can rest assured that it will continue to be quite positive in the near future. From here, the probe goes into corruption.

When the corruption level is high, no investment will take place. The UAE is the least corrupt country in the Arab world and offers a business-friendly environment, with an effective and efficient public administration. The UAE Penal Code criminalizes active and passive bribery, embezzlement, and abuse of functions. Anti-corruption and anti-fraud legislation are enforced, and practices of bribery and petty corruption are uncommon. Gifts and hospitality are regulated under the UAE's anti-corruption framework. Facilitation payments are treated as bribes and are thereby illegal. Transparency International has published the Corruption Perceptions Index (CPI) since 1995, annually ranking countries by their perceived levels of corruption [13]. The CPI generally defines corruption as the misuse of public power for private benefit. Table 4 presents the ranks

assigned to the UAE for the last five years.

TABLE 4: CORRUPTION RANKING FOR THE UAE, 2015 TO 2019

Year	2015	2016	2017	2018	2019
Global Rank	23	24	21	23	21

Source: Compiled from the Corruption Perceptions Index 2015 to 2019.

The Corruption Perceptions Index ranking reinforces that the UAE has a low level of corruption and is improving year by year in bringing down corruption. Furthermore, the laws and legislations enforced in the UAE play an important role in attracting FDI. Table 5 gives the level of the risk in UAE in different areas according to the United Arab Emirates Corruption Report (2020) published in the Risk and Compliance portal by GAN [14].

TABLE 5: LEVELS OF RISK IN DIFFERENT AREAS IN UAE, 2020

Risk Area	Risk Level
Judicial system	Moderate
Police	Low
Public services	Moderate low
Land administration	Moderate low
Tax administration	Low
Customs administration	Low
Public Procurement	Moderate
Natural resources	Moderate

Sources: Compiled from the Risk and Compliance portal by GAN.

Corruption is a moderate risk for companies in the United Arab Emirates. The UAE offers a business-friendly environment with an effective and efficient public administration.

B. Infrastructure

Infrastructure is a major determinant of FDI. Excellent infrastructure plays a major role in the profitability of Multinational Corporations and their decision about FDI location. UAE invested heavily in the development of the infrastructure by building airports, roads, bridges, telecommunication foundation, and ports and building smart cities within the country such as Masdar City. UAE believes that well-built infrastructure work in line with attracting foreign investors as their mobility will be faster and more efficient. UAE had invested heavily in telecommunication since 2000, which supported the country's economy and FDI development [15]. UAE is injecting heavy investments in building-projects, roads, and bridges, enhancing airports, and working on expansion projects in ports. Etihad Rail is one of the huge infrastructure projects in UAE as it will connect the seven emirates, which will ease the mobility among them and will reduce truck traffic from roads [16]. MNCs will have faster, safer, and more efficient mobility in UAE when Etihad Rail becomes operational. Table 6 gives the global ranking of the UAE for the period 2015 to 2019 based on road connectivity, quality of road infrastructure, railroad density, the efficiency of train services, airport connectivity, the efficiency of air transport services, liner shipping connectivity, the efficiency of seaport services, utility infrastructure, electricity access, electricity supply quality, exposure to unsafe drinking water and reliability of water supply [17].

TABLE 6: INFRASTRUCTURE: GLOBAL COMPETITIVENESS INDEX RANKING OF THE UAE – 2015 TO 2019

Year	2015	2016	2017	2018	2019
Global Rank	4	4	5	15	12

Source: Compiled from Global competitiveness reports from 2015 to 2019.

The UAE has an excellent infrastructure, and the Government is continuously investing in infrastructure projects to have the best infrastructure in the world. Currently, it is ranked the twelfth best in the world and the best in the Middle East. Besides, the UAE had built ports with a huge capacity, which support the movement of products with highly systemized operations. The highly developed ports in UAE compromise the ports in the regional area, making UAE a hub for foreign investments. Table 7 lists the major seaports in the UAE.

TABLE 7: MAJOR SEAPORTS IN THE UAE

Location	Emirates	Name of Seaports
Abu Dhabi	Abu Dhabi	Zayed Port
Dubai	Dubai	Mina Rashid
Jebel Ali, Dubai	Dubai	Jebel Ali Port
Khor Fakkan	Sharjah	Khor Fakkan
Ras Al Khaimah	Ras Al Khaimah	Mina Saqr
Fujairah	Fujairah	Fujairah Port
Abu Dhabi	Abu Dhabi	Khalifa port
Hamriyah Free Zone	Sharjah	Hamriyah port

Source: Compiled from [18].

The UAE's seaports are international and regional hubs and an essential factor in driving economic growth and facilitating economic diversification. According to the World Shipping Council, two of the world's top 50 container ports are in the UAE, with Dubai featuring among the top ten. Overall, 61% of cargo destined for GCC states arrives via the UAE's seaports. The UAE has 12 commercial trading ports, other than oil ports. It contains 310 berths, with a cargo tonnage of 80 million tonnes. The well-built infrastructure plays a paramount role in attracting FDI into the UAE.

C. Geographical Location and Global Connectivity

Location advantage is an important factor that determines manufacturers' accessibility and provides them with cost benefits compared to regions where there is no location advantage. United Arab Emirates' location is unique as it shares its borders with Saudi Arabia, Qatar, and Oman. UAE's location makes it a great destination to merge with countries around it. Since decades back, UAE connected the east and the west, which encouraged trade between the UAE and other countries. The geocentric locational advantage of the UAE provides investors with opportunities to maximize production and trade efficiencies by applying cost reduction methods. Over two-thirds of the world's population lives within eight hours of flight from the UAE, and one-third lives within four hours. To capitalize on the great location, the UAE has built ports, roads, and airports to connect the world and trade between east and west, encouraging FDI inflow into the country.

D. Developed Financial System

Financial institutions with sufficient liquidity and transparency to grant quick loans at competitive rates is an important determinant. The financial systems stability, tax

rate enforced, and the pegged UAE Dirham with US dollar are all factors that helped in gaining the investors' confidence and trust in the UAE [15]. Table 8 gives the ranking for the financial system of the UAE from 2015 to 2019 based on the availability of domestic credit to the private sector, financing of SMEs, venture capital availability, market capitalization, insurance premium, soundness of banks, non-performing loans as a percentage of loan portfolio value, credit gap and banks' regulatory capital ratio [17].

TABLE 8: FINANCIAL SYSTEM: GLOBAL COMPETITIVENESS INDEX RANKING OF THE UAE – 2015 TO 2019

Year	2015	2016	2017	2018	2019
Global Rank	20	28	24	31	31

Source: Compiled from Global competitiveness reports from 2015 to 2019.

During the five years, it is observed that the UEA has been gradually declining in the global ranking, but it still continues to have a well-developed financial market in the Middle East. However, the regulators will have to take immediate measures to strengthen the financial system further.

E. Stable Currency

The volatility of the exchange rates influences the flow of FDI. Investors prefer a stable and less volatile currency, which ensures that their profitability is least affected by the vagaries of exchange rate fluctuations. They need not spend their time and money managing the forex risk.

Since November 1997, the currency of the UAE is pegged to the US dollar. Hence the investors are assured an exchange rate of USD = 3.6725 UAE dirhams. This pegged exchange rate is an important attraction for the inflow of FDI into this country.

F. Ease of Doing Business

The World Bank Group's Doing Business Report ranks economies based on their ease of doing business, covers regulations affecting ten areas of the business life cycle which are, starting a business, dealing with construction permits, connecting electricity, registering property, securing credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency [19]. A high ease of doing business ranking means the regulatory environment is more conducive to the starting and operation of a local firm. Table 9 gives the ranking for the UAE from 2015 to 2020.

TABLE 9: EASE OF DOING BUSINESS: UAE'S RANKING

Year	2015	2016	2017	2018	2019	2020
Global Rank	22	31	26	21	11	16

Source: Compiled from the Doing Business Reports from 2015 to 2020.

The UAE is at rank 16 out of 190 countries in the World Bank Group's 2020 Ease of Doing Business report, with a score of 80.9 out of 100 and is the strongest performer overall in the Middle East and North Africa region. The Arab world's second-biggest economy is already implementing an array of reforms to improve the ease of doing business, attract foreign investors, create jobs, and diversify its economy away from oil. The UAE has allowed 100% foreign ownership of companies in 13 sectors, from

manufacturing to renewable energy. It also eased visa restrictions, provided incentives for small and medium enterprises, and introduced a new insolvency law to help UAE residents clear bad debts. Table 10 shows the number of days required to start a business in the UAE [20].

TABLE 10: TIME REQUIRED TO START A BUSINESS IN THE UAE

Year	2015	2016	2017	2018	2019
Global Rank	8.3	8.3	8.3	3.8	3.8

Source: World Bank.

The time taken to start a business in the UAE is less than four days, quite marvelous, and undoubtedly will influence the investment decisions dramatically.

G. Expo 2020

Although Expo 2020 had been postponed till October 2021 due to the Covid-19 pandemic, the preparation plans had been implemented. Dubai Expo 2020 (from October 1, 2021, to March 31, 2022), will be the first world expo to be held in the Middle East, Africa, and South Asia region. Expo is considered to be the third-largest global event in terms of economic and cultural impact, after the Olympic Games and the FIFA World Cup; the event attracts millions of visitors to the host nation during its six-month duration, is likely to attract substantial foreign investment into the UAE and will build upon UAE's core economic sectors of financial services, construction, tourism, and hospitality.

V. CONCLUSION

The UAE is a young country whose leaders had strategically planned the development of the county. No doubt, the FDI into the country has played a significant role in developing and diversification of the economy. Political stability, well-developed infrastructure, geocentric geographical location, and well developed strong financial sector, stable currency, and the proactive government have all contributed to the FDI-attractiveness of the UAE. Each of these macro factors has contributed in different degrees in making the UAE an attractive FDI destination in the Middle East. The global indicator of political stability shows that the UAE maintains a good position in political stability; the transfer risk, expropriation risk, and political violence risk are very low in the UAE. The UAE has an excellent infrastructure and is currently ranked the twelfth best globally and the best in the Middle East. The UAE continues to have a well-developed financial market in the Middle East. On the ease of doing business parameter, the UAE is the best performer overall in the Middle East and North Africa region. Currently, it takes less than four days to start a business in the UAE. Moreover, the liberalization policies of the government such as allowing a 100% foreign ownership of companies in many sectors right from manufacturing to renewable energy, the eased visa restrictions, the new insolvency law, the signing of the Abraham accord, and resolving of the more than a three-year prolonged diplomatic spat between Qatar and few GCC countries including the UAE and the normalization of relations and reopening of borders with Qatar will make the region itself more attractive for the FDI.

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