



EXAMINATION OF FOREIGN DIRECT INVESTMENT CLIMATE IN BAHRAIN

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Abstract

Foreign Direct Investment plays a vital role in the host nation's economic growth. The governments try continuously to attract foreign investments into the country by promulgating different investment-friendly policies. This study aims to determine the status of Bahrain as a destination for FDI and the factors that contribute to this attractiveness. The study covers a period of five years, from 2015 to 2019. Different factors attracting FDI are analyzed. It is observed that Bahrain is an FDI-attractive destination with a developed infrastructure, strong financial system, low expropriation risk, medium currency inconvertibility, and transfer restriction risks. The investor-friendly policies make doing business in Bahrain easy and smooth.

Keywords: Bahrain, Financial System, Foreign direct investment, Infrastructure, Political risk

INTRODUCTION

Foreign Direct Investments (FDI) plays a significant role in the development of the developing nations, and the investing corporates or individuals or nations get assured control of ownership in the business in the host nation. FDI has increasingly gained prominence in developing the nations in the Gulf Cooperation Council (GCC), with these nations' governments coming out with investor-friendly policies and taking measures to remove or minimize administrative barriers in the nation. As a result, the inflow of FDI to nations in the GCC has increased, helping the nations to develop their different sectors right from manufacturing to final services, and at the same time enabling investors to reap benefits of higher returns.

Bahrain, officially the Kingdom of Bahrain, is a country in the Persian Gulf. The island nation comprises a small archipelago made up of 51 natural islands and an additional 33 artificial islands, centred around Bahrain Island, which makes up around 83% of the country's landmass. The country is situated between the Qatari peninsula and the northeastern coast of Saudi Arabia, to which it is connected by the 25-kilometer King Fahd Causeway (Wikipedia, 2021). Bahrain has a population is over 1.641 million people (in 2019), of which around half are non-nationals. The small island nation covers an area of 780 km², making it slightly larger than Singapore (699 km²).

The advent of the Arab Spring and the Financial crisis had adversely impacted the Middle East region. However, within a short period, Bahrain has successfully bounced back with needed developments to attract FDI to the nation's different sectors. The nation has an attractive open regulatory environment with proper integration with other nations in the region, attracting different global companies looking for a gateway to the Middle East markets through Bahrain.

Bahrain is trying to be one of the most developed countries around the world. Foreign business ownership has been permitted in more than 90% of the business, which has resulted from the increase in the excellence of logistical infrastructure, the higher number of English speaking population, and a large number of skilled workers. Table 1 provides data on FDI inflows into Bahrain for the past five years.

Table 1: Foreign Direct Investment in Bahrain: Net Inflows (USD in Millions)

Year	2015	2016	2017	2018	2019
FDI Inward Flow (million USD)	65	243	1,426	1,654	942

Source: Compiled from World Investment Report, 2020

Bahrain has seen fluctuations in inward investment over the past two decades. The country experienced a drop in FDI in the wake of the 2008 financial crisis and subsequently during the Arab Spring uprisings of 2010–12. However, FDI had been growing steadily over the years, reaching \$1,426 million in 2017 until it peaked in 2018 at \$1,654 million, before falling sharply in 2019 to \$942 million. The FDI peak in 2018 was largely a result of economic reform and new growth within its manufacturing sector. Key reforms included permission for full foreign ownership in companies involved in oil and gas drilling activities. FDI inflows to Bahrain decreased by 43% in 2019, according to the United Nations Trade Conference on Trade and Development (UNCTAD) 2020 World Investment Report. According to UNCTAD, global flows of FDI will be under severe pressure due to the Covid-19 pandemic and are expected to fall by up to 40%. FDI in Bahrain is expected to continue on a downward trend, compounded by the economic fallout from the Covid-19 crisis.

This study aims to investigate the factors that affect foreign direct investment in Bahrain. The findings of the study would help the investors arrive at a better decision regarding FDI into Bahrain, and similarly, help the regulators and other stakeholders formulate appropriate policies and take necessary steps to enhance the FDI-attractiveness of Bahrain. The rest of the paper is organized as follows. In Section 2, a literature review on FDI is presented. Section 3 presents the methodology used for the study, while Section 4 focuses on analysis and discussions. In Section 5, the conclusions of the current study are stated.

LITERATURE REVIEW

Various countries all over the world are struggling and competing to attract FDI into their economies. Inward FDIs, as it is always believed, help boost economic growth and achieve the recipient countries' sustainable development (Gharaibeh, 2015). A large number of studies on FDI have been conducted in different parts of the world, and the majority of the studies have been mainly concerned with various host-country determinants that are associated with attracting firms to specific locations (Balasubramanyam et al., 1996; Borensztein et al., 1998; Alguacil et al., 2002; Chakraborty & Basu, 2002; Liu et al., 2002; Baharumshah & Thanoon, 2006; Fernandez et al., 2020; Alshamlan et al., 2021).

Wells (1987) pointed out that good infrastructure is necessary to attract export-oriented investment. Similarly, Rolfe & White (1992) determined that infrastructure quality is significant in the country's attractiveness for offshore manufacturing investment. Hobday (1994) pointed out that foreign firms were attracted to Singapore partly by transportation and communications infrastructure efficiency.

Political stability and reliability determine the FDI inflows. Multinational Corporations (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, non-allowance of fund transfer, currency convertibility, war, bureaucracy, and corruption. The study by Root & Ahmed (1979), and Schneider & Frey (1985), looking at aggregate investment flows into developing economies, found that political instability significantly affects FDI inflows.

The study by Bouchoucha & Benammou (2020) examined the effect of governance on the attractiveness of FDI through a sample of 41 African countries to identify the institutional quality aspects that affect the attractiveness of FDI in African countries, using both the static panel data approach and the dynamic panel approach. The empirical results showed that the attractiveness of FDI to African countries is positively correlated with the control of corruption, governments' effectiveness, the quality of regulation, and the voice and accountability.

Numerous studies have been conducted on FDI in different parts of the world, but most of them have been focusing on a few of the FDI determinates; moreover, studies focusing on Bahrain are few and are constrained by focusing only on a few factors. Hence, this study is undertaken to analyze the FDI environment in Bahrain from a holistic perspective. In short, the trend in FDI flows differs by region and country. Although FDI has innumerable effects on host countries' economies and most countries are trying hard to attract FDI, the inflow of FDI continues to be uneven, with some countries getting the lion's share and others barely getting any.

METHODOLOGY

The main objective of this study is to find out the status of Bahrain as a destination for FDI and the factors that attract FDI into Bahrain and how these can be improved, and the factors that hinder the flow of FDI into Bahrain, and how these can be reduced. The study is solely based on secondary data collected from local, regional, and international agencies like the Government of Bahrain, Central Bank of Bahrain, 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 proposes to cover a period of five years from 2015 to 2019, as it is reasonably long enough and would give sufficient data to arrive at rational conclusions. The collected data are subjected to time series analysis and relative ranking.

ANALYSIS AND DISCUSSIONS

The Global Competitiveness Report 2019, published by the World Economic Forum, assesses the competitiveness landscape of 141 economies, providing insight into the drivers of their productivity and prosperity. These 141 economies account for 99% of the world's GDP. The competitiveness ranking is based on indicators organized into 12 pillars: Institutions; Infrastructure; ICT adoption; Macroeconomic stability; Health; Skills; Product market; Labor market; Financial system; Market size; Business dynamism; and Innovation capability. Each indicator or 'pillar' uses a scale from 0 to 100 to show how close an economy is to the ideal state or frontier of competitiveness in that area (Global Competitiveness Report, 2019). The Report series remains the most comprehensive assessment of national competitiveness worldwide. Table 2 presents the year-wise ranking of Bahrain by global competitiveness index for the years 2015 to 2019.

Table 2: Global Competitiveness Index: Ranking of Bahrain - 2015 to 2019

Year	2015	2016	2017	2018	2019
Global rank	39	48	44	50	45

Source: World Economic Forum, Global Competitiveness Report 2015 to 2019

The data in Table 2 show the relative ranking of Bahrain has been fluctuating. In relation to 2015, the current rank had declined to 45, though it improved over the year 2018 when the rank was 50. The analysis of various determinants of FDI begins here, starting with the infrastructure.

Infrastructure

Infrastructure is a major determinant of FDI. Excellent infrastructure plays a major role in MNCs' productivity and profitability, and thus, their decision about FDI location. Table 3 gives the global ranking of Bahrain 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.

Table 3: Infrastructure: Global Competitiveness Index Ranking of Bahrain - 2015 to 2019

Year	2015	2016	2017	2018	2019
Global Rank	29	32	33	30	31

Source: Compiled from Global competitiveness reports from 2015 to 2019

Infrastructure is vital for the long-term growth and competitiveness of economies. It helps create jobs and improves living standards, and the Government is continuously investing in infrastructure projects to create world-class infrastructure in the country. In 2019 Bahrain was ranked 31 in the Global competitiveness report, whereas in 2018, the rank was marginally higher at 30. Overall the position of Bahrain is appreciable. For getting a clearer picture, let us cruise into the Logistics Performance Index.

Logistics Performance Index

Logistics is the backbone of the trade, and good logistics can reduce trade costs and make countries compete globally. Getting logistics right means improving infrastructure, skills, customs and regulations, policies, and governance at the right proportion. The Logistics Performance Index (LPI) is reported by the World Bank once every two years, based on qualitative and quantitative data on six core performance components: (1) The efficiency of customs and border clearance, (2) The quality of trade and transport infrastructure, (3) The ease of arranging competitively priced shipments, (4) The competence and quality of logistics services, (5) The ability to track and trace consignments, (6) The frequency with which shipments reach consignees within scheduled or expected delivery times. Table 4 gives the ranking of Bahrain from 2014 to 2018.

Table 4: Logistics Performance Index: Ranking of Bahrain - 2014 to 2018

Year	LPI Parameter-wise Global ranks						
	Global Rank	Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
2014	20	30	49	58	51	42	119
2016	44	41	48	41	33	44	51
2018	59	63	68	55	58	60	68

Source: Compiled from Logistics Performance Index, 2014 – 2018

Bahrain's ranking in the World Bank's Logistics Performance Index deteriorated from 20 in 2014 to 59 in 2018 globally among 160 countries based on six different parameters, and the deterioration is noticed in all parameters. The position of Bahrain among the emerging markets is fifteen in the 2020 Agility Emerging Markets Logistics Index. To stay competitive, the policymakers have to take immediate steps to strengthen the logistic sector, and investments in this sector are highly recommended and will be beneficial not only for the investor and the country but also for the trade in the region.

Political Risk

Bahrain is a constitutional hereditary monarchy, ruled by the House of Khalifa since the 18th century. The Sunni Khalifa family rules over a Shia majority population. The chief of state is the king, and the head of government is the prime minister. Since 1973 Bahrain has an elected legislative assembly; it consists of the Council of Representatives (the lower house) and the royally-appointed members of the Consultative Council (the upper house). MNCs usually assess political risk before investing in any country. There are many forms of political risks, but the extreme form is the possibility that the host country will take over a subsidiary. However, this form of political risk is an extreme case and not very common in today's global world. The more common forms of political risk include the host government's negative attitude to MNCs, 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 like political risk short term, political risk medium/long term, special transactions risk, transfer risk, expropriation risk, and political violence risk; under each of these indicators countries are classified into seven categories: from 1 (low risk) to 7 (high risk); among them, those related to Direct Investments is probed into a little bite.

Transfer Risk

The currency inconvertibility and transfer restriction risk refer to the inability to convert and transfer out of the host country any funds related to the investment. The average value for Bahrain during the study period was 3 in 2015 and 2016, but since then, it is 5. This indicates that currency inconvertibility and transfer restriction risk is medium for Bahrain.

Expropriation Risk

The risk of expropriation encompasses all discriminatory measures taken by a host government which deprive the investor of its investment without any adequate compensation; and also includes events of the embargo, change of (legal) regime and denial of justice, and the probability of an adverse change in attitude towards foreign investments. The average value for Bahrain during the study period is 3 for each year from 2015 to 2019, except in 2016, where it was marginally lower at 2. This indicates that expropriation risk is low in Bahrain. Table 5 gives the consolidated ranking for the period 2015 to 2019.

Table 5: Country Risk: Credendo Group Index Ranking of Bahrain - 2015 to 2019

Year	2015	2016	2017	2018	2019
Transfer risk	3	3	5	5	5
Expropriation risk	3	2	3	3	3

Source: Compiled from Credendo Group index reports 2015 to 2019

The international investors can be sure that they will get a warm welcome in Bahrain. Their assets will not be expropriated, and funds may not be blocked, enjoy relatively easy convertibility, and face fewer bureaucracy bottlenecks. Now let us go deeper into the level of corruption in Bahrain.

Corruption

Corruption distorts competition and investment and hinders free and fair trade. The study by Mauro (1995) found that corruption lowers investment and thereby economic growth. Corruption erodes trust, hampers economic development, and further exacerbates inequality, poverty, social division, and environmental crises. When the corruption level is sufficiently high, no investment will take place. Transparency International has published the Corruption Perceptions Index (CPI) since 1995, annually ranking countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. The CPI generally defines corruption as 'the misuse of public power for private benefit.' Table 6 presents the ranks assigned to Bahrain during the last five years.

Table 6: Corruption: Global Ranking of Bahrain - 2015 to 2019

Year	2015	2016	2017	2018	2019
Global Rank	50	70	103	99	77

Source: Compiled from the Corruption Perceptions Index 2015 to 2019

The Corruption Perceptions Index ranking shows that the nation has to improve a lot in containing and controlling corruption. The data in the table show that the country's position on this parameter is weak. The government will have to take appropriate steps immediately to reduce the levels of corruption.

Developed Financial System

Financial institutions with sufficient liquidity and transparency to grant quick loans at competitive rates is an important determinant. The banking system of Bahrain consists of both conventional

and Islamic banks. The total number of banks in Bahrain is 93, comprising 31 retail banks (14 locally incorporated and 17 branches of foreign banks) and 62 wholesale banks, eight representative offices of banks, and one Bank Society. Of these, 19 are Islamic banks (Central Bank of Bahrain, fact sheet, 2020). The banking sector has played a pivotal role in the emergence of Bahrain as a leading financial center in the region. As of July 2020, banking sector assets stood at over US\$212.6 billion, more than five times the annual GDP of Bahrain. (Central Bank of Bahrain, 2020).

Table 7 gives the ranking for the Financial System of Bahrain (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.

Table 7: Financial System: Global Competitiveness Index Ranking of Bahrain - 2015 to 2019

Year	2015	2016	2017	2018	2019
Global Rank	33	43	46	33	37

Source: Compiled from Global competitiveness reports from 2015 to 2019

Bahrain was ranked 33 in 2015 and dropped to 46 by 2017, from where it improved back to rank 33 in 2018. However, in 2019 it has declined to rank 37, which calls policymakers and regulators' attention to take a special interest in strengthening the financial system. A modernized technology-driven financial system is the need of the hour. Today we are in a world where payments can be sent with a click of a button from the most basic cell phone. Countries must have financial sectors that ensure stability while offering deep, well-regulated markets and being agile enough to respond to rapid innovation in the industry. Thus the Bahrain financial sector offers plenty of investment opportunities that can be availed by both domestic and international investors, who can make the financial sector of Bahrain and the region stronger and investor-friendly.

Technology Adoption and Innovation

Technology is an important consideration made by foreign investors because it determines the scope of operational efficiency. From an investment perspective, the lack of efficient technology systems implies that operations would be slow and costly. Thus, there will be a need for choosing destinations with a higher level of technology. Table 8 gives Bahrain's ranking on ICT adoption from 2015 to 2019 based on mobile-cellular telephone subscriptions, mobile-

broadband subscriptions, fixed broadband internet subscriptions, fiber internet subscriptions, and internet users.

Table 8: ICT Adoption: Global Competitiveness Index Ranking of Bahrain - 2015 to 2019

Year	2015	2016	2017	2018	2019
Global Rank	34	37	31	38	46

Source: Compiled from Global competitiveness reports from 2015 to 2019

In ICT adoption, Bahrain's position is deteriorating, and the rank has fallen from 34 in 2015 to rank 46 by 2019. The policymakers and regulators will have to come out with policies that would attract investment into this sector, paving the way for this sector's development, which is of prime importance in this digital and technology era.

Ease of Doing Business

The World Bank Group's Doing Business Report ranks economies based on their ease of doing business. These reports provide quantitative indicators on regulation for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. 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 Bahrain from 2015 to 2020.

Table 9: Ease of Doing Business: Bahrain's Ranking - 2015 – 2020

Year	2015	2016	2017	2018	2019	2020
Global Rank	53	65	63	66	62	43

Source: Compiled from the Doing Business Report 2015 to 2020

Doing Business data for the past six years show that the position of Bahrain had been weakening till 2018, but since then, it has shown strengthening signs and is ranked 43rd out of 190 countries in the World Bank's Doing Business 2020 report, up 19 places on the previous year as well as being named the fourth most improved economy in the world. Still, plenty has to be done to make Bahrain investor-friendly and attractive to Foreign Direct Investments.

CONCLUSION

Due to the important role FDI plays in economic growth, the governments try continuously to attract foreign investments into the country by promulgating different investment-friendly policies. The parameters making Bahrain an FDI-attractive destination are its infrastructure developments, low expropriation risk, medium currency inconvertibility, medium transfer restrictions, and a strong financial system that has successfully attracted numerous foreign banking organizations to establish their presence in the country. Moreover, the country's policies and measures to make doing business easy have started showing results. It is ranked 43rd in the World Bank's Doing Business 2020 report, up 19 places on the previous year, and named the fourth most improved economy in the world. However, there are plenty of improvements required in many areas, and the concerned departments and authorities will have to take immediate and commendable steps in bringing in the required improvements on a war footing basis if the nations have to stay attractive and competitive to investors, especially when the FDI inflows into Bahrain decreased by 43% in 2019. Likewise, the policymakers will have to make policies that are attractive and friendly to international investors.

Exchange Rate: Since 1980, the Bahrain dinar has been pegged to the US Dollar at a rate of 0.376 Dinar = 1 USD.

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