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The Impact of Export, Import and Foreign Investment on Economic Growth of GCC States

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Abstract:

This research examines and discuss the linkage among elected variables, namely real Gross Domestic Production (GDP), FDI inflows (FDI), non-oil export (EX) and Import (IM). It tries to analyse the relationship for the said variables over the period 2000 to 2021. The study has used Kao Residual Cointegration test in addition to the qualitative analysis that based on the data of study and graphs. However, it found that a persistent weak level of non-oil export could be linked to the slight contribution of non-oil sector to GDP. Also, the non-oil industrial policies have not importantly affected the growth of non-oil exports. Except for UAE, Saudi Arabia and Bahrain. However, the inward FDI has an indirect impact on the level of GCC countries, where the empirical model indicted that the cointegration of FDI could be considered as an agent for diversifying these economies, and then the impact of GDP on improving GCC' trade level is associated with size of inward FDI.

Keywords: FDI, Economic Growth, Export, Import, GCC

JEL classification: F10, F14, F43, L38, O11

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أثر الصادرات، الاستيراد والاستثمار الأجنبي في النمو الاقتصادي في دول مجلس التعاون الخليجي

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ملخص:

يسعى هذا البحث إلى اختبار ومناقشة العلاقة بين الناتج المحلي الإجمالي الحقيقي، وتدفقات الاستثمار الأجنبي المباشر الداخل والصادرات غير النفطية والاستيراد في دول مجلس التعاون الخليجي خلال المدة 2000 إلى 2021. بالإضافة إلى التحليل الوصفي للبيانات المتاحة، استندت منهجية البحث على اختبار التكامل المشترك للبواقي لبيانات السلسلة الزمنية بعد التأكد من استقرارية البيانات إحصائيا. أهم الاستنتاجات تمثلت في ان استمرار ضعف مساهمة الصادرات غير النفطية يرجع بالدرجة الأساس إلى ضعف مساهمة القطاعات غير النفطية في الناتج المحلي الإجمالي. إضافة الى ذلك، تم التوصل إلى ان السياسات الصناعية المتبعة لم تؤثر بشكل كبير في رفع مستوى الصادرات غير النفطية باستثناء الإمارات العربية المتحدة والمملكة العربية السعودية والبحرين. كما أثبت النموذج القياسي المستخدم أن تدفقات الاستثمار الأجنبي المباشر أثرت بشكل غير مباشر في الصادرات من خلال تأثيرها الكبير في نمو الناتج المحلي الإجمالي، إذ ان هناك تكامل مشترك لمتغير الاستثمار الأجنبي الداخل مع الناتج المحلي الإجمالي في الأمد الطويل، وهذا ينعكس إيجابا على المتغيرات الأخرى في النموذج المستخدم.

الكلمات المفتاحية: الصادرات، الاستيراد، النمو الاقتصادي، الاستثمار الأجنبي المباشر.
تصنيف (JEL): F10, F14, F43, L38, O11

1. Introduction.

Since the end of 1980s, most developing countries had launched the macroeconomic reforms that are an essential base for achieving sustainable economic growth, where policy makers are recognizing that adopting economic diversification policies has become a significant policy to avoid the social pressures. They announced industrial policies targeted at industries they believe can deliver rapid economic growth. Therefore, government's choice of investment in industries is often targets non-traditional industries in which the country has no comparative advantage. However, diversification could be defined as a production factor (Romer 1990), where GCC governments have aimed to diversify their economies via empowering investment policies that attempt to attract foreign investors. This has targeted raise non-oil export and reduces the high reliance on extractive industries.

In general, the foreign trade and investments in the GCC states have increased gradually during the period from 2000 to 2021. As known, FDI can enhance diversification and reduce share of extractive industries, and lead to progress the non-oil economy. However, economic policies have been adopted in GCC economies, where trade and foreign direct investment (FDI) have been liberalized.

Besides, improving level of GDP in GCC is an economic priority, where remarkable number of free zones and free trade areas in addition to industrial cities had emerged especially in UAE and Saudi Arabia. Therefore, the current study tries to extrapolate how much economic policies and strategies adopted have impacted on the GCC economy. Overall, this study tries to evaluate the extent of success of economic diversification through the analysing the linkage among real GDP, inward FDI and foreign trade to assess the real impact of the governmental economic efforts over the period 2000 to 2021. Therefore, we can say that real economic policies can contribute to the increase of level of non-oil national income resources. Hence, the study tries to empirically analyse the GCC's economic policies to find out whether the GCC states have achieved advanced level in the non-oil sectors. However, although the oil sector and oil-based industries can achieve high level of revenues, but it does not implies enhancing level of diversification and economic stability due to the fluctuations of global oil prices. Meaning that, the importance of diversification does not only embody in the increase of level national income as far as in the reinforcement sustained non-oil GDP and mitigate world economic shocks via activating local and foreign investments that can meet the local needs and increase level of surpluses.

2. Literature Review

The economic literatures have already asserted the significance of economic diversification in achieving a robust economic system as well as avoiding disadvantages of world economic fluctuations and financial crisis. The GCC states have achieved discernible trade integration, and have succeed in motivating capital mobility, where this could be related to facilities and regulations adopted. Moreover, FDI could increase growth and creating job opportunities and enhancing backward and forward linkage between sectors in the host countries. Furthermore, (Majid 2006) asserted that GCC' economies are importantly needed to follow new policies that lead to increase level of investments and non-oil GDP via utilizing the surpluses achieved from gas and oil sectors. And another study (Hertog 2007) indicated that GCC governments have empowered privileges to their societies via attracting more investments and facilitating processes regarding that. These countries generated various options that assist the economy in reinforcement the economic activities and mitigation the negative impacts of world economic fluctuations due to the high dependency on oil export. In this respect, (Tariq et al 2009) revealed that economic diversification is associated with the lag of oil revenues. This study found also that growth is not highly linked with the increase of level of population, which indicate a modest level of productivity of human resources. (J. E. Peterson 2009) affirmed that the share of the non-oil industries has not achieved high contribution to GDP. Moreover, the study found that the weakness of service sector has led to decrease level of diversification in GCC states.

Besides, (United Nations et al 2010) in its report about improving level of non-oil GDP growth and diversification confirmed that this highly reliant with the increase of level of regional activities. So, the integration between countries is a key factor for growth strategy, in which the private investment is the main determinant of diversification and growth. Therefore, all policies adopted by policy makers and stakeholders should lead to enhance the market share of private sector via availing business environment. Thus, policies facilitating the GCC' intra-trade and capital transfer are the major means in this respect. Moreover, (Mouawiya 2010) found that manufacturing sector in GCC states is mainly related to non-oil sectors in the long term, where income and population growth stimulate manufacturing in the GCC. Furthermore, it has indicated that manufacturing has no important role that led to stimulate the real GDP in the short term. Also, the governmental expenditure has no tangible effect on non-oil GDP and diversification.

As known, the economic diversification as a concept means empowering the economic base through creating an economic environment that can cause an activation of economic activities and strengthen the trade ties and international business with other economies. Therefore, most countries try to open their economies for rapid economic growth, in this regard World Investment Report (UNCTAD 2012) mentioned that there are major factors that affect the growth level, which are size of capital invested, affordable technologies, skills of labour forces, advanced transportation system and infrastructure. However, the most important matter to diversify an economy is the level of diversification, which sector could achieve much more economic growth and lead to link with various economic activities inside the economy?

However, the economic diversification in GCC countries means reducing the big share of oil sector along with developing other sectors, particularly agriculture and industry, and supporting non-oil exports to create new revenues for financing the public budgets. Therefore, the economic diversification considers as an important way for economic development. It leads to alteration the structure of the GCC economy via utilizing the surpluses of oil revenues in non-oil sectors as a main strategy of GCC countries. In this respect, (Martin 2013) reported that diversification in the GCC states is restricted by various barriers, which are world growth policies and the competed economic activities.

(Callen et al 2014) found that increased level of diversification is an important factor that can reduce the fluctuations of the world oil market, raise level of production. (Reda et al 2014) asserted that the failure of diversification in GCC states is mainly related to market failures, where the government ought to change policies related to labour forces incentives and firms as well.

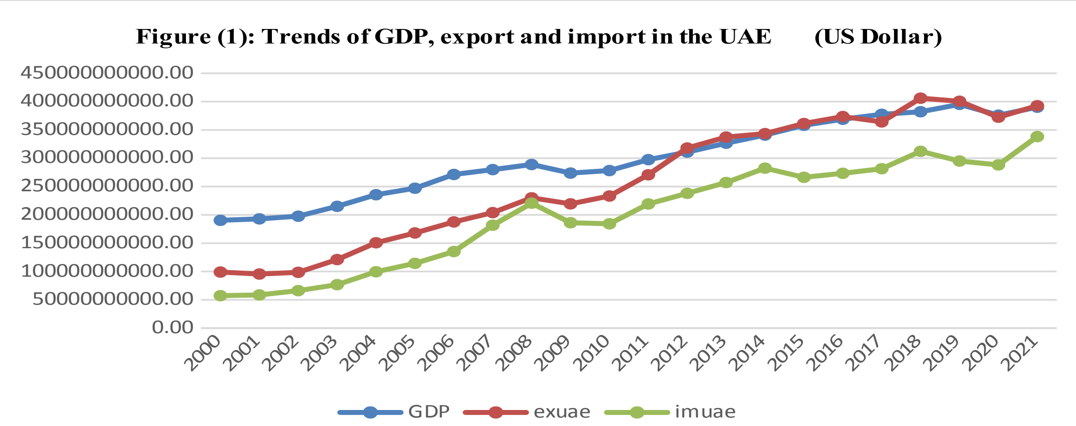
Also, (CREC 2014) mentioned several approaches linked with GDP expansion such as policies that lead to increase existing specializations and enhancing skills and capacity of the area workforce. And most important approach is to encourage reinvestment of wealth within the region. In addition, the economic diversification could ensure the oil revenues rights of next new generations in GCC countries, where the oil as a depleted resource, the GCC's economic policy should guaranty the future of their economies. This policy could be achieved by expansion the agriculture and industrial production sectors and create new capacities that enhance level of real GDP and commodity exports. Moreover, (Mamdoh 2014) revealed that there is a weak level of diversification in Saudi Arabia from 1970 to 2010.

Overall, the importance of economic growth comes from its linkage to economic policies (Alola, et al 2019) that target to enlarge size of economy, achieving surpluses, and then raise level of foreign trade. Furthermore, the high contribution of oil sectors in GCC countries, except for Bahrain, considers as a major challenges which represented in volatilities of global oil prices (Nusair, 2019; Zmami, et al 2020), where other studies (Alharman, et al 2022; Jreisat, et al 2022; Bugshan 2023) found that oil price fluctuations affect even the banking system, economic performance and firms' profitability in GCC countries.

From the above, it was noted that attempts of rising level of non-oil GDP and trade are existed in the GCC' policies but the presence of a big share of oil sector to GDP -except in UAE and Bahrain- could be related to policies and incentives associated with foreign trade and investments which does not lead to increasing level of competition in non-oil sectors due to a high level of economic openness. However, the current study tries to contribute via using different methods to evaluate the GCC's policies toward foreign trade and investment. Therefore, it will examine four cointegrated variables, and the major purpose, is that, to assess which variable is mainly affect in improving of economic growth and diversification and what is the effect of foreign trade on the GCC economy? In addition, this paper will focus on analysing the direct and indirect linkage between the variables examined to analyse the strength of each variable by testing its impact on the GCC economy as a whole and other variables related to GDP and foreign trade. Based on that, the study will include two major parts, the analytical part that set an analysis to the trend of real GDP, export, import and FDI inflows to GCC states over the period from 2000 to 2021. The second part will be specified to the empirical methods, and other sections related- model estimation and result discussion, and then conclusion and policy recommendations.

3. Trends of Growth, Trade and FDI in GCC states

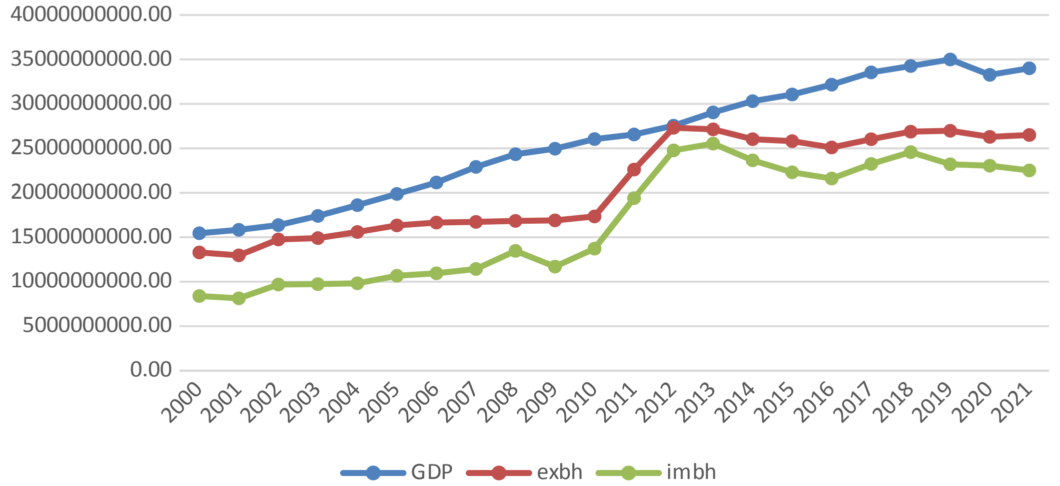
During the period spanned from 2000 to 2021, the real GDP, and trade in GCC states have witnessed in general a parallel increase except for Oman and Saudi Arabia.



Source: By the author based on database of SESRIC, Database of Statistical, Economic and Social Research and Training Centre for Islamic Countries, http://www.sesric.org/baseind-step5.php.

The figure above shows an evident relationship between real GDP growth, export and import during the period 2000 to 2021 in UAE. It was noted a remarkable increase in the level of export started from 2012 to 2018. This could be linked with the efforts devoted for diversification and enhancing level of production that have relatively empowered the non-oil sectors towards increasing level of productivity and then achieving high economic surpluses. However, the growth of non-oil sector is amounted by 1.7 percent in 2018 (Khan 2019), where this proves successful policies related to diversification over the period studied. Based on that, the increased level of export can give an evident which is the UAE economic policies have focused on export-oriented industries as a major policy for diversification. In addition, this policy has led to attract foreign companies that affect positively in activating industrial areas and freezones and then enhancing level of transport sector. All this were a corner stone to mitigate share of oil sector to GDP and raise level of non-oil real GDP in UAE.

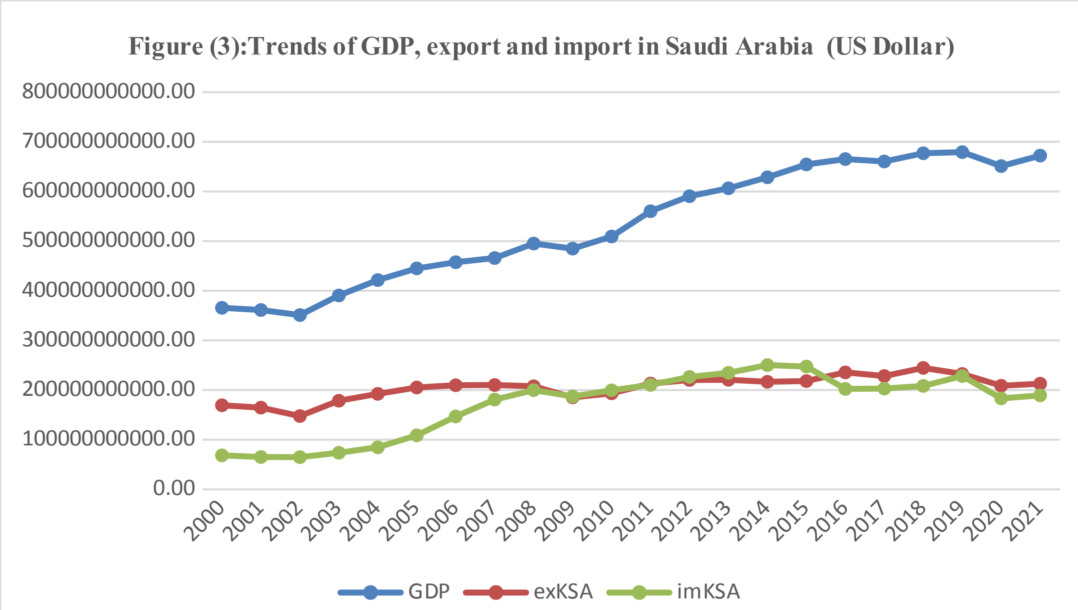
Figure (2): Trends of GDP, export and import in Bahrain (US Dollar)



Source: By the author based on database of SESRIC, Database of Statistical, Economic and Social Research and Training Centre for Islamic Countries, http://www.sesric.org/baseind-step5.php.

Similarly, figure 2 above shows an incremental growth of the real GDP in Bahrain, and we note that export and import have increased sharply in the duration spanned from 2010 to 2012 in which the nominal growth level amounted by 11.8% after a negative economic growth level in 2009, where crude petroleum and natural gas controlled on 24.8 percent of GDP, and financial corporations and manufacturing sector share reached to 20.6 and 15.4 percent respectively, in addition to other sectors such as real estate and business activities (6.4 percent), trade (7.2 percent) and governmental services which contributed by 12.1 percent (CBB 2010).

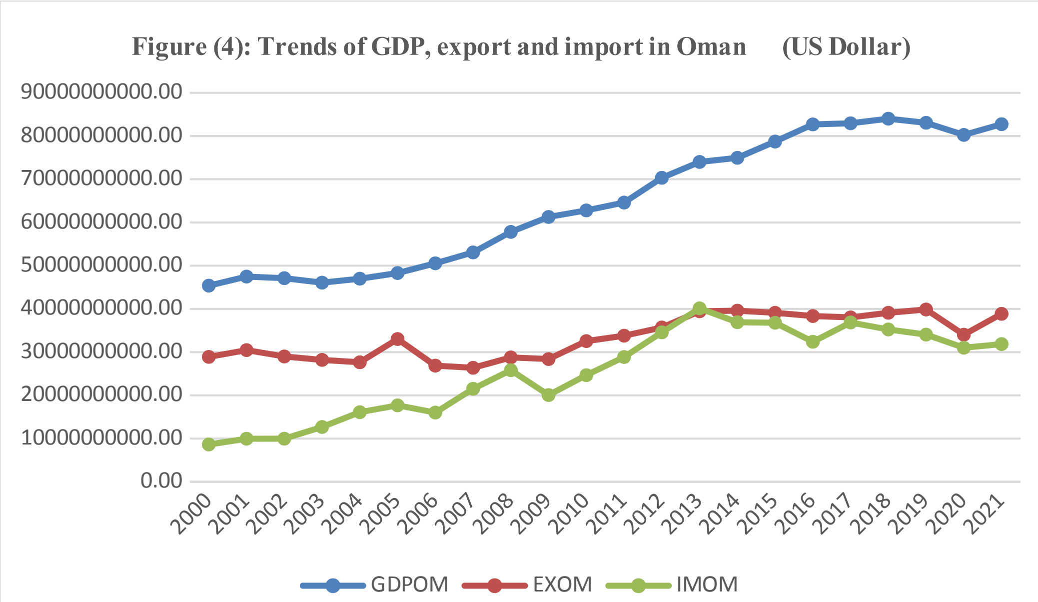
This progress, however, could be related to the success of economic policies that targeted enhancing level of economic growth via non-oil sectors, particularly services and manufacturing sectors. In other words, the Bahraini GDP growth reflects that the rise of production is more than that of total consumption, where values of GDP in general is more than that of export and import over the period studied.



Source: By the author based on database of SESRIC, Database of Statistical, Economic and Social Research and Training Centre for Islamic Countries, http://www.sesric.org/baseind-step5.php.

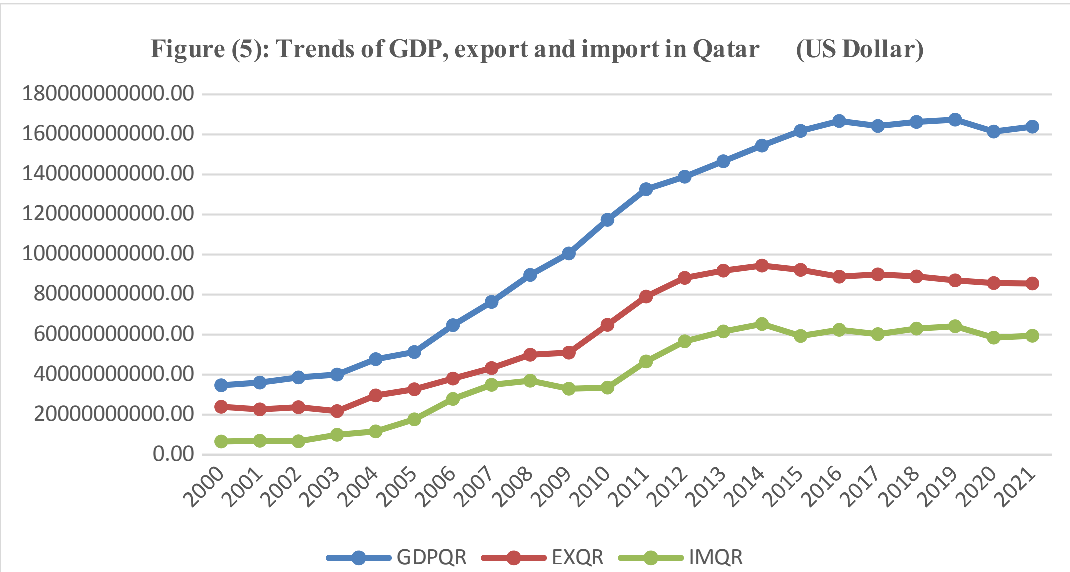
This also means the absence of a high reliance on the foreign markets which associated with a high level of Non-oil GDP growth resulting in rising of level of value added over the period studied. Furthermore, this indicates that export is a dominant factor that led to reinforcement real GDP. Moreover, we note that export and import in Saudi Arabia have witnessed a modest increase compared to the growth of GDP, where this case could be linked with the high share of oil export revenues in comparison with other sectors. Also, we can say that the high GDP growth is related to domestic investments more than that of its export.

However, the figure above could explain that the economic growth in Saudi Arabia does not rely significantly on its export as much as the other sectors that was able to raise level of value-added and increasing level of economic growth. In addition, the figure can illustrate that a big size of Saudi economy compared to other GCC states can reinvest surpluses of oil revenues and cause a remarkable increase in the level of GDP. In addition, it was noted that The Omani real GDP has achieved an increased growth compared to export and import. However, the period spanned from 2013 to 2021 has not witnessed an increase in the level of both variables, export and import. This case could be illustrated by the direction of the economic policy to meet the local demand due to the rise of level of actual consumption. Furthermore, figure (4) below explains that the economic policy was not able to increase the local capacity toward international markets due to the limitation of size of economy. In other words, the Omani economy has paid a high attention to the domestic markets because the absence of export– oriented policies. Consequently, the level of Omani export growth has not witnessed an evident increase, particularly the period from 2013 to 2019. This implies a modest non-oil activities and based on that new policies ought to be adopted to enhancing level of real non-oil GDP that can lead to achieve an expansion to the size of economy which considers an important agent for attracting investors and then improving level of growth.



Source: By the author based on database of SESRIC, Database of Statistical, Economic and Social Research and Training Centre for Islamic Countries, http://www.sesric.org/baseind-step5.php.

In contrast, it was clearly noted in Figure 5 that Qatar is still highly reliant on the foreign markets in which the high level of economic growth represented by its real GDP for the period studied has led to raise level of export and import. So, the presence of a correspondent relationship means achieving a relatively high level of surpluses in comparison with Oman, Saudi Arabia and Kuwait.



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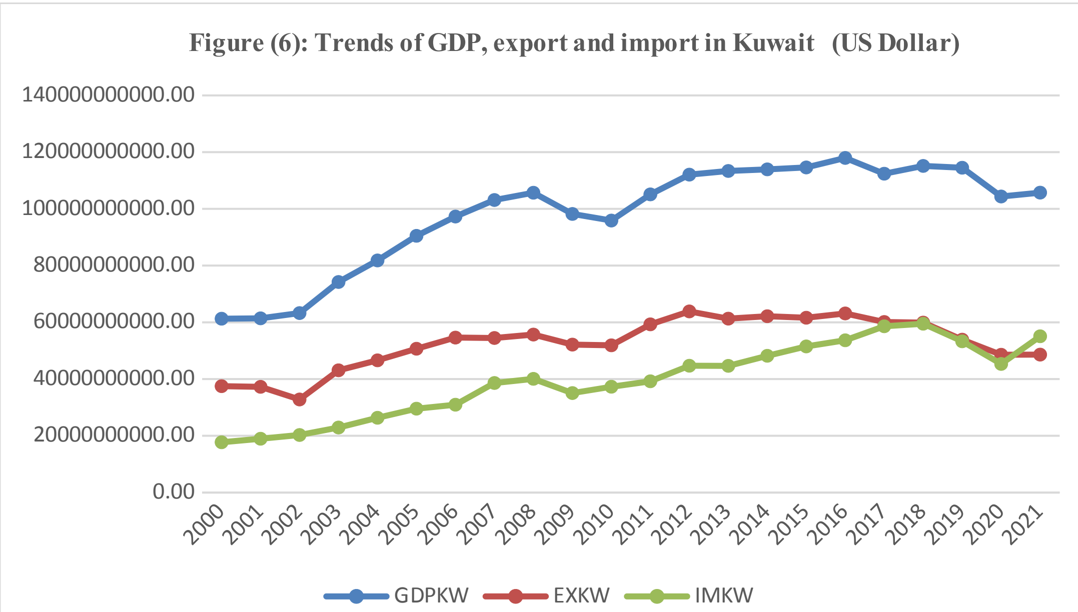
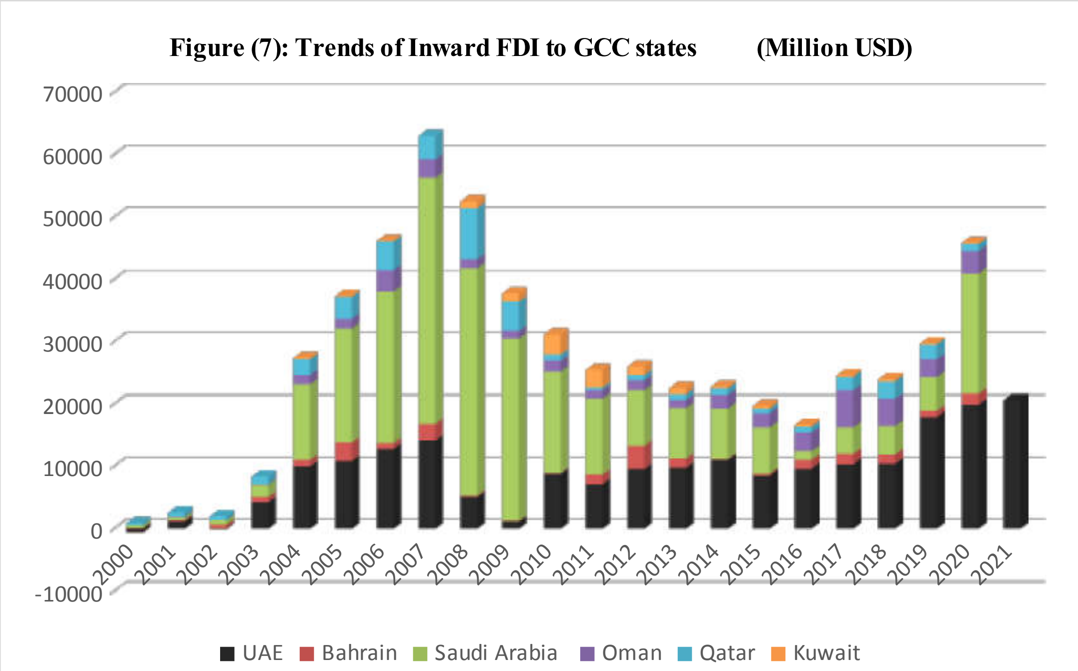
In addition, the data shows that Kuwait has achieved a modest economic growth, particularly over the duration from 2013 to 2021. Also, it is noted that the growth decrease has led to a negative impact on the export level, where it was declined obviously from 2016 to 2021. On the contrary, level of import has increased especially for the period 2000 to 2018, as shown in the following figure. However, the figure above depicts a parallel relationship between the variables, and this reflects the big well-known contribution of gas export to GDP in Qatar, in which the GDP growth is linked with liquid gas exports. Accordingly, this in turn lead to increased level of imports that meet needs of the economy from various goods. In other words, the figure above explains that the increased level of economic openness in Qatar is linked with the high level of economic growth represented by real GDP.

Hence, we can say that the Kuwaiti diversification policies have not influenced to enhancing level of economic sectors and expand the local market via increasing level of value added, particularly for non-oil industries, in which there is a modest increase in the level of export which amounted by 5.8 percent, while the imports witnessed a 10.4 percent increase in 2004 (Bertelsmann 2010). This implies that the growth level of consumption is more that of production, and based on that, this means that the economic growth in Kuwait is still importantly linked to the world market because of the high reliance on the crude oil production and imports. This could be noted clearly when we focus on the big gap between non-oil exports and real GDP in figure 6 below.



Source: By the author based on database of SESRIC, Database of Statistical, Economic and Social Research and Training Centre for Islamic Countries, http://www.sesric.org/baseind-step5.php.

Regarding the FDI inflows to GCC states, it was noted that Saudi Arabia and UAE have occupied the major share of attracting FDI to the GCC states, this could be linked with the size of economy, where both countries represent around 50 per cent of the total size of the six countries. However, the inward FDI has reached to USD 20.66, 19.28 in 2021 for UAE and Saudi Arabia consequently. The compound growth rate was 18 percent and 23.5 percent over the period 2000 to 2021 for the said countries.



Source: By the author based on database of SESRIC, Database of Statistical, Economic and Social Research and Training Centre for Islamic Countries, http://www.sesric.org/baseind-step5.php

Hence, the incremental increase in the level of FDI could be explained by the successful policies that attracted foreign investors. This also can be related to the facilities offered by both countries in which the inward FDI has positively affected the local economy as a significant source for mobilization the capitals and then improve level of local economy in general, whereas the rest of GCC states have represented modest shares of FDI. Meaning that, both Saudi Arabia and UAE enjoy a significant level of competition due to abundance of investment opportunities that supported by energy resources and attracted facilities that can ease doing businesses.

4. Methodology:

The study will use Kao Residual Cointegration test with panel data method to analyse the long-run association among the variables studied for each GCC country, FDI, GDP, Non-oil export and import. The study examines annual data from 2000 to 2021. The variables tested will be measured by Million USD for FDI and by USD for other variables. The functional relationship is written in the following equation:

$GDP = f\,(Ex, Im, FDI)$ (1)

However, the equation above could be formulated in its econometric model as follows:

$\log GDP = \alpha_0 + \beta_1 \log Ex + \beta_2 \log Im + B_3 \log FDI + U_t$ (2)

α0 represents the intercept term, *β1, β2, and β3* are coefficients to be examined, and these coefficients are more than zero. *U* is the random variable, and the subscript "*t*" is indicating the time periods.

Prior to running the model, we conducted the inverse roots test as shown in figure (8) below. It proves that the regressed model is stationary, where all roots are inside the circle in the figure below. However, the unit root test is essential to ensure stationary data. Accordingly, the results obtained could be considered are not spurious. This means that the variables adopted will be valid and economically meaningful as well.

5. Model Estimation and Results Analysis:

To measure the relationship between the variables studied, the Kao Residual cointegration test is used with panel data technique, as shown in table (6), Where for UAE, the variables defined above are reformulated as the following (*EXUAE, FDIUAE* and *IMUAE*). For Bahrain (*EXBH, FDIBH* and *IMBH*), and similarly to Saudi Arabia (*EXKSA, FDIKSA* and *IMKSA*), then for Oman (*EXOM, FDIOM* and *IMOM*), and for Qatar (*EXQR, FDIQR* and *IMQR*), and finally for Kuwait are written (*EXKW*, *FDIKW* and *IMKW*).

The model above is useful for having a more comprehensive analysis of the link among variables examined in this study, where many studies engaged this test for measuring the strength of the linkage between variables (Beveridge 1981; Efron 2004; Hernandez 2012). However, the estimated model above shows that all examined data are cointegrated in the long run, this illustrates a big relationship among the variables studied. Hence, the result in table (6) below could interpret an evident relation between foreign trade and the GCC' local economies. Accordingly, the results obtained indicate the significant linkage derived from enhancing the financial surpluses invested and its impact on economic growth, export and import alike. Moreover, the long run cointegration proves how much economic policies succeed in utilizing the high contribution of oil sector in GCC economies. In this regard, we can say that the FDI flows to GCC countries have led to enhancing level of oil-based industries, where the result shown below is consistent with the data analysed in figures 1 to 6.

Table 6: Kao Residual Cointegration test result for the model

Kao Residual Cointegration Test
Series: GDP EXUAE FDIUAE IMUAE EXBH FDIBH IMBH EXKSA FDIKSA IMKSA EXOM FDIOM IMOM EXQR FDIQR IMQR EXKW FDIKW IMKW
Date: 06/04/23 Time: 11:50
Sample: 2000 2020
Included observations: 126
Null Hypothesis: No cointegration
Trend assumption: No deterministic trend
User-specified lag length: 1
Newey-West automatic bandwidth selection and Bartlett kernel

	t-Statistic	Prob.
ADF	-2.946489	0.0016
Residual variance	1.280113	
HAC variance	0.520747	

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(GDP)
Method: Least Squares
Date: 06/04/23 Time: 11:50
Sample (adjusted): 2004 2020
Included observations: 102 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
RESID(-1)	-1.204623	0.164919	-7.304313	0.0000
D(RESID(-1))	0.141251	0.100768	1.401747	0.1641

R-squared	0.473405	Mean dependent var	-0.096840
Adjusted R-squared	0.468139	S.D. dependent var	1.006214
S.E. of regression	0.733820	Akaike info criterion	2.238306
Sum squared resid	53.84914	Schwarz criterion	2.289776
Log likelihood	-112.1536	Hannan-Quinn criter.	2.259148
Durbin-Watson stat	1.800529		

Source: By the author using Eviews Software.

From the table above, we can deduce that the diversification polices in GCC countries ought to be focused on maximizing the real GDP parallel to attraction FDI. Then the inward FDI could enhance local investment and reduce the total import compared to export. However, the significant relationship among the study variables can be attributed to the GCC' investment policies that mainly attracted FDI to extractive industries and oil-based industries to achieve a high increase in the level of GDP. Meaning that, the progress gained from FDI flows to GCC countries was not engaged to reinforcement the interaction between GCC's economies and foreign investments. Therefore, the strategic policies since 2000s have focused majorly on oil sector, where the extractive sector remains significantly contributed to the GDP, while it was not dominant sector in both Bahrain and UAE.

The result above confirms what were already revealed. Therefore, the investment policies must be focused on hosting non-oil-based investment that can lead to increase level of linkage between non-oil sectors and enhance level of GDP higher than that of export and import.

6. Conclusion and Policy Recommendations

The study clearly points to the pivotal role that the state may play, through enhancing level of GDP in fostering FDI and trade, particularly export, where the study found that these variables play a dominant role in diversifying the GCC's economies in comparison to the extractive industries, and non-oil export (ex) as a proxy of manufacturing growth. However, the study analysed the GCC' economic policies via these three variables and their impact on the real GDP using Kao residual cointegration test to obtain a robust result for our analysis. The study found that a weak level of non-oil export and import could be highly linked to modest level of manufacturing sector. Meaning that, the FDI attracted to GCC countries, and the non-industrial policies have not importantly affected the increase of level of non-oil real GDP - except for UAE, Saudi Arabia and Bahrain- this proves that the high reliance on oil sector contributed to increasing level of import even with a significant level of economic growth represented by real GDP. Furthermore, it has extrapolated that the weakness of level of export is linked to failure of diversification policies in Kuwait, and this could be related to the low level of incentives which were not provided for promoting new investments in non-oil sectors by lowering domestic barriers to entry. This indicate that the oil-based industries are remaining importantly contributed to GDP. Therefore, we conclude the presence of an indirect effect of FDI inflows in GCC states. The empirical model indicted that the cointegration of FDI inflows could be considered as an agent for diversifying these economies, and then the impact of GDP on increasing level of foreign trade is associated with size of FDI inflows.

For the policy recommendation, the study suggests that there should be further consideration for attracting foreign direct investments, particularly in Oman and Bahrain along with domestic investments via easing and speeding up privatization programs. Finally, the study recommend that policies ought to be geared towards the identification of new investment opportunities in non-oil sectors. This may be achieved through promotion policies and more facilities offered to enhance role of private sector in reinforcement level of non-oil economic growth. This, however, would undoubtedly serve to encourage the investment climate in attracting much more investments and create a competitive environment that led to raise level of non-oil economy.

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