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DETERMINANTS OF FOREIGN DIRECT INVESTMENTS IN THE GCC COUNTRIES: A SOCIO-POLITICAL STUDY

Mohd Naved Khan
Assistant Professor, College of Administrative and Financial Sciences, Saudi Electronic University, Riyadh, Kingdom of Saudi Arabia
https://orcid.org/0000-0003-1182-3785
o.m304@yahoo.com

Abstract

This paper attempts to identify the factors contributing to the growth of foreign direct investments (FDI) in the GCC countries. This socio-political study utilized a secondary method, time series data that has been obtained from the World Bank. This study uses several variables, but only a few are used in the actual analysis of the data given the limited time and resources for the resourcing of such data and the fact that some countries do not disclose some of the economic data and indicators for their foreign direct investment growth over the years. Given the results, the key factor is exports from the sale of oil and its products, the international tourism level of the country, the factor endowments, including minerals such as titanium and iron, factors such as expenditure on the military, the level of asses from foreign trade, otherwise known as net foreign assets, and the level of value addition that takes place in the country try to allow foreign multinational companies to thrive, and hence such economies grow.

Keywords: Foreign Direct Investment, Determinant of FDI, GCC, socio-political study.

DETERMINANTES DE INVESTIMENTOS ESTRANGEIROS DIRETOS NOS PAÍSES DO GCC: UM ESTUDO SOCIO-POLÍTICO

Resumo

Este artigo tenta identificar os fatores que contribuem para o crescimento dos investimentos estrangeiros diretos (IDE) nos países do GCC. Este estudo sociopolítico utilizou um método secundário, dados de séries temporais que foram obtidos do Banco Mundial. Este estudo utiliza várias variáveis, mas apenas algumas são utilizadas na análise real dos dados, dado o tempo e recursos limitados para a obtenção de tais dados e o fato de alguns países não divulgarem alguns dos dados e indicadores econômicos para seus países estrangeiros. crescimento do investimento direto ao longo dos anos. Diante dos resultados, o fator chave são as exportações a partir da venda de petróleo e seus produtos, o nível de turismo internacional do país, o fator doações, incluindo minerais como titânio e ferro, fatores como gastos com militares, o nível de asses do comércio exterior, também conhecido como ativos externos líquidos, e o nível de agregação de valor que ocorre no país tentam permitir que empresas multinacionais estrangeiras prosperem e, portanto, essas economias cresçam.

Palavras-chave: Investimento Estrangeiro Direto, Determinante do IDE, GCC, estudo sociopolítico.

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1. INTRODUCTION

The term GCC countries refers to countries that formed the Gulf Cooperation Council and are composed of six countries. These countries include Bahrain, Oman, Qatar, the UAE, Kuwait, and Saudi Arabia, and mainly depend on export earnings from vast oil reserves. The economies of these countries have been growing rapidly owing to the high revenue they receive from the production of crude oil, which has been the backbone of such economies (Sarno & Taylor, 1999). A few years ago, the prices of petroleum and petroleum products dropped because of the sharp decrease in oil demand before the 2008-2009 economic crisis. The drop in the prices of oil products was due to the increase in demand that overrode the supply that the oil-producing countries in the OPEC could supply to the global market. Countries, therefore, struggled in the wake of such an oil crisis and sought ways to diversify their economies (Purizaga-Sorroza et al., 2022).

This calls for discussion, and economic policy analysts came up with the solution that the countries form a trading block that would enable them to engage in other countries and offer foreign investors a conducive environment for them to trade. This was the advent of foreign direct investment in the Gulf Cooperation Council (Borichev et al., 2022).

FDI has become one of the main cornerstones of these countries, and has helped them propel themselves to the top of the Asian regional economic ladder.

For instance, GCC countries are trying to come up with economic policies that will benefit international investors and, at the same time, benefit the country in which the investment is made (Chang, 2014).The Kingdom of Saudi Arabia and Oman are two countries that have always insisted on council members to ensure they put up policies that will create an enabling environment for foreign companies to invest in (Moosa, 2009; Huabil et al., 2022). Therefore, this study mainly focuses on the determinants of foreign direct investments among these countries while simultaneously focusing on the role of the GCC in the stimulation of policies that promote foreign multinationals' investments.

Such policies include relieving tariffs and protective barriers, changing the taxation policy for foreign startup companies (Akhyadov et al., 2022; Chang, 2014), and changing the currency regimes to strengthen the value of their currencies to encourage foreign trade between what is produced domestically by these multinationals and the products produced from outside (Livson et al., 2021; Mina, 2009). In this way, countries are guaranteed healthy and positive terms of trade and a balance of payments from international trade.

This study analyzes the determinants of foreign direct investments in the GCC through research question formulation and a hypothesis testing procedure, which will then determine the results and implications of the analyzed determining factors.

The research questions that this research seeks to answer are the following:

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- What significant factors positively influence the level of foreign direct investments in the GCC countries?
- What factors negatively influence the level of foreign direct investments among the GCC countries?

2. HYPOTHESES

Following the above literature and introduction, this study will seek to examine and investigates the correlation between the level of FDI and the aforementioned factors. Many factors affect the forging of direct investments among GC countries; however, the most important ones are used for this analysis. Therefore, these form the basis of our hypothesis testing, and when we reject the null hypothesis, the hypothesis as stated will be taken as true or in favor of the alternative hypotheses. So the hypotheses area;

1. There is a negative relationship between the inflation level of a given country and FDI level of foreign direct investment.
2. There is a positive relationship between the trade level in the GCC and its level of foreign direct investment.
3. A positive relationship exists between a country's GDP in the GCC region and its foreign direct investment level.
4. There is a positive relationship between external trade and GCC countries' level of foreign direct investment.

This, therefore, means that the dependent variable, is the foreign direct investment (FDI), while the four main factors, coupled with the others mentioned above, are the independent variables, namely the level of GDP, the inflation, trade volumes, external balance of trade or balance of payment, and the other factors like factor endowments, political stability, unemployment and employment levels, the level of corruption, such that when a country can control the corruption (Mina, 2009), then it attracts a greater number of foreign direct investors, the tariffs and other protective barriers put in place, the rule of law and the level of accountability (Mina, 2009). This affects the country's global economic ranking in terms of the ease of doing business.

3. LITERATURE REVIEW

Foreign direct investment has become one of the most important foreign exchange and economic growth sources for many countries, even in developed countries such as Europe and America (Mina, 2009). GCC countries are trying to develop policies that will ensure that the investment climate in their countries is favorable for attracting foreign investors. Previous

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research has shown that the higher the inflation rate, the greater the level of tension (Mina, 2009). This tension negatively affects the economic environment, thereby reducing investments' earnings. Risk-averse foreign investors have been interviewed in the past and have confirmed that the high inflation and continuing trends over the years lead to unfavorable foreign direct investments in the host country because investors fear putting their profits, earnings, and capital in an environment that is high in inflation, given how inflation erodes the consumption capacity of the consumers, and hence they demand less (Mina, 2009).

Inflation negatively affects planned and unplanned consumption at the aggregate level, and this leads to a situation in which investors are forced to charge higher prices for their products due to the high inflation that keeps factors of production expensive (Mina, 2009). With such a move, the high prices charged by firms mean that consumers will demand less, and, as a result, inflation leads to reduced investments by domestic and international companies in the host country. Inflation should be as minimal as possible, or at least constant, to ensure that the economic environment is stable, and thus interest rates do not fluctuate, in which case investors are encouraged to invest more.

Chang (2014) claims that when countries have poor monetary and inadequate fiscal policies, inflation is inevitable, which negatively influences the level of willingness of foreign investors to invest in such countries. Counties with unsustainable deficits are often susceptible to increasing inflationary pressures and trends, and these lead to a situation in which the production costs increase, the barriers increase, instability in the socio-economic and political aspects abound, and this leads to an unfavorable investment environment for foreigners. Therefore, as the literature supports, inflation leads to high costs of living, high costs of production, transportation, and fuels, which are major factors in production, and also increase drastically, negatively affecting FDIs.

Another factor that influences foreign direct investments is factor endowments. Countries are endowed differently- some countries have a higher level of factor endowments such as more minerals, cheaper labor and capital inflows, lower production costs, and extraction of primary resources, while others are also better able to produce agricultural goods due to more fertile soils than others (Mina, 2009). Therefore, countries with more of these factor endowments have higher chances of luring foreigners to come and invest in their economy to help them achieve growth and infrastructural development.

The other factor is GDP, which positively influences the FDI volume of foreign direct investment. For instance, a country with a high yearly GDP means that its economy is growing, and healthy competition thrives in such an economy (Mina, 2009). Foreign direct investments thrives in a stable and growing economy that guarantees investment return. Therefore, in GCC countries, whose economies are constantly growing given the high output from petroleum and other manufacturing industrial goods, there is a great chance for FDIs to invest there.

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However, prior research studies have provided mixed results that portrayed foreign direct inflows and their determinants (Mina, 2009). Many researchers have used several data like panel, time-series, and cross-sectional data to determine the relationship between the determinants of FDI and the influence of these factors on the growth of such economies. As discussed above, these determinants are positive, whereas others are negative (Mina, 2009).

However, most of them portray a situation in which only a few negatively influence FDI, such as inflation, and the direction in which one looks at a factor (for instance, political stability or instability). According to Sarno and Taylor (1999), changes that have been employed in developing countries like most GCC countries, with regard to the promotion of foreign direct, have been beneficial and have brought about a net increase in net capital inflows from outside into these countries. Empirical data and research have also pointed out that indeed the foreign direct investments from one country to another stimulate growth of the export earnings (Chakrabarti, 2001). As a result, investments complement trade balances and, hence, are healthy for the host country (Mina, 2009).

Research has also pointed out that if a given country has better policies that promote internal and external trade, then such a country will attract more foreigners willing to invest in it. This is more common when developed countries with superior capital and technologically advanced production methods invest in developing countries that have more natural resources and less capital for extraction, value addition, and manufacturing. For instance, we have seen this in sub-Saharan Africa, where Chinese and Western countries invest in capital flows in such economies to extract minerals and establish FDIs and multinational companies to increase output in such countries (Sarno & Taylor, 1999). This is known as outward-led growth, in which countries that encourage foreign investors implement policies that encourage foreign exports at the expense of importation through the use of tariffs. Moreover, the volumes of imports also played a similar role in that export volumes played a role as far as foreign direct investments were concerned.

The volume of imports increases, leading to a higher level of foreign direct investments (Erfani & Berger, 2020). For instance, according to Aziz and Mishra (2017), the relationship between external trade balance and the influence of the same on foreign direct investments a country undertakes. For instance, if a country has a negative trade balance, it has an unfavorable balance of payments and exports less than imports. Therefore, this would worry for a foreign investor who may be reluctant to invest in a country that imports more at the expense of exports (Erfani & Berger, 2020). Countries that export less than imports have a negative balance of trade and proper terms of trade in the international market for goods and services. Such countries find it difficult to lure, encourage, and poach the best investors abroad to invest in their countries. This may also mean that such countries have worse production

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policies and put more tariffs that jeopardize investors' willingness to conduct business in foreign countries.

Mina (2009) proposed a hypothesis that empirically points out that a country with higher unemployment levels encourages more foreigners to invest in them. For instance, sub-Saharan Africa and parts of Asia and North Africa have high and ballooning levels of both structural and disguised unemployment (Adames, 2000), which means that their majority populations are not actively employed; this has been an opportunity for these foreign multinationals to come into these economies to invest and create job opportunities for the vast number of unemployed persons (Erfani & Berger, 2020). In conclusion, the rate of inflation, commercial connections between countries, gross domestic and gross national products, savings by the country's citizens, exchange rates, and market sizes, among other factors described in the introduction, are the main factors determining the level of foreign direct investments (Erfani & Berger, 2020).

This current research aims to state the factors in general that affect the foreign direct investments among the six countries in the GCC economic block, and then to further determine which ones are the negative and which positively influence the level of FDI. This study relies on empirical research and presents data analysis from the latest data on the five main indicators of FDI (Dondashe & Phiri, 2018). These five main indicators are inflation, trade volume, GDP, and external trade balance. These were the predictors. The dependent variable which is to be determined is the level of FDI.

3.1. Gap analysis

Nearly 45 years have passed since the term foreign direct investment was coined. Surprisingly, most studies on this topic revolve around the determinants of FDI and its benefits and shortcomings. The possible areas of study proposed by this research would be to study the effect of industry-level factors on the success of FDIs (Adames, 2000). For instance, given their factor and mineral endowments, certain industries do better than others, and other countries are better able to develop other industries than others (Dondashe & Phiri, 2018). A country that produces cheap capital or labor can develop certain industries faster than others.

Manufacturing industries require heavy investments in terms of capital that have to be generated from foreign exchange. Considering that most GCC countries are either middle income or lower middle income, they cannot develop their capital intensive factor and hence resort to labor intensive, which may hinder growth in certain industries than others (Erfani & Berger, 2020). This means that given a country’s endowment, according to the Ricardian theory of comparative advantage, there is a need to study the broad effects of these factors from an industry-specific point of view, as some industries require more technology, expensive

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capital, and labor than others, and these dynamics should be able to shape the kind of discussions that are geared towards luring foreign investments (Dondashe & Phiri, 2018).

4. RESEARCH METHODOLOGY

This study uses secondary, time series data that has been obtained from the World Bank, and the link to the site has been provided by https://data.worldbank.org/indicator/BN.KLT.DINV.CD. The focus is on the countries that form Gulf Council cooperation, given their global outlook and the fact that they encourage more outward-oriented trade strategies (World Bank, 2018). The significance of Middle Eastern countries has also been considered because of their oil reserves, which many firms today seek to exploit by investing in their economies (Dondashe & Phiri, 2018). A generalized least squares regression analysis was performed. The factors have been analyzed based on their coefficient to show their direction, whether they are negatively related to FDI or positively related.

In this methodology, there are outliers in the data collected, which are considered normal in any data collection or sampling procedure (Cheng & Kwan, 2000). Therefore, the influent findings are defined in this section as the findings affected by the independent variables or facts in the model and, as such, are inclined towards one or more sides of the regression equation or estimates. A studentized residual was used. According to Hair et al.(2013), studentization has been done to classify the figures, and other intervening variables have also been identified, such as the size of the market of the host country, the flexibility of such countries' markets, international balances of trade, factor endowments, trade tariffs, and other protective barriers, among other variables, have been omitted in the analysis due to their high VIF value and because they cannot easily be quantitatively measurable(Erfani & Berger, 2020).. The analysis tool in this research is Excel software and possibly SPSS-Statistical packages for social scientists.

5. RESULTS AND DISCUSSION

5.1. Model specification

The model has been estimated and can be specified as follows:

FDI is the dependent variable determined by these factors or regressors: inflation, trade, GDP, external balance, and autonomous FDI. Autonomous FDI is the level of foreign investment that is not determined by these regressing factors in this model and can also be defined as the level of investment by foreigners, even when all the factors are zero.

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So the model specifications given by;

FDI=β0+β1Infl+β2Tr+β3GDP+β4EXLBA+εi

Where Infl is inflation, EXLBA is the external balance, GSP is the gross domestic product, FDI is foreign direct investment, Tr is trade volume, and FDI=β0 is autonomous foreign direct investment. Table 1 shows the data obtained from the World Bank for the independent and dependent variables.

Table 1. data obtained from the World Bank for the independent and dependent variables.

country	Infl	TRD(%age of GDP)	GDP	EXLBA
Bahrain	-2.3	142.00	34729	4356648
Saudi Arabia	3.4	51	700118	14582677
Oman	-0.9	81	73971	5505551
UAE	-2.1	168	358869	108446483
Qatar	-2.5	90	144411	11868681
Kuwait	2.1	98	105960	11445869

Cronbach's alpha is a statistical measure of how close any given variable value is to one another and how they are related as a group. This alpha was used to measure the reliability of the test scores and the results (Leeper, 2017). Given that the regression analysis provides the expected signs or direction of the variables between the independent and dependent variables, we can conclude that Cronbach's alpha has been used accordingly.

From the regression analysis output, we can see that the factors explain the variation in foreign direct investments by 92.6%, from the coefficient of determination of 0.926. This means that the factors or repressors in the model explain more than 92% of the variations in the foreign direct investments within the GCC region, and hence, this is a model of good fit (Leeper, 2017). The model factors that are not explained by the given independent variables of trade, inflation, GP, and external balances are only 7.4% (Table 2).

Table 2. Summary Output

SUMMARY OUTPUT	
Regression Statistics	
Multiple R	0.962327659
R Square	0.926074523
Adjusted R Square	0.630372613
Standard Error	4852489.822
Observations	6

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From the Pearson correlation coefficient, we have the data results below (table 3)

Table 3. Dara results from Pearson correlation coefficient

Variable	1	2	3	4	5
FDI	1.00				
Infl	0.164	1.00			
Tr	0.405	-0.01	1.00		
GDP	0.204	0.259	-0.029	1.00	
EXLBA	0.114	0.384	0.125	0.199	1.00

The regression analysis is therefore shown below (Table 4):

Table 4. Regression analysis results

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	2.94972E+14	7.3743E+13	3.131784	0.39778871
Residual	1	2.35467E+13	2.35467E+13		
Total	5	3.18519E+14			

The coefficient results of the given independent variable are shown in the table below (Table 5):

Table 5. Coefficient results of the given independent variable

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	-1246598.733	11929255.42	-0.104499291	0.9337143
INFL	-52631.97245	1351880.47	-0.038932416	0.9752274
TRD(%age of GDP)	18098.27627	112427.5083	0.160977296	0.8983904
GDP	3.204960639	15.93393485	-0.201140564	0.8736361
EXLBA	0.178739729	0.114366328	1.562870232	0.3623676

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Table 6. Descriptive statistics

		DESCRIPTIVE STATISTICS			
	INFL	TRD	GDP	EXLBA	FDI
MEAN	-0.38333	105.00	236343	26034318.2	4569793
SD	2.52382	47.55313	253993.7	40565366.5	7981464
MAX	3.4	168.00	700118	108446483	19880000
MIN	-2.5	51.00	34729	4356648	-2325098
SKEWNESS	0.891022	0.485336	1.576763	2.39738596	1.828831

From the analysis (Table 1-6), we can see that the major determinants of foreign direct investments are three. The others were not a factor in the analysis given their lack of quantitative measurability (Leeper, 2017). Therefore, the inflation rate has a negative relationship with the level of foreign direct investment. For instance, the coefficient of inflation in this model was specified as − -52631.97245. As inflation increases, foreign direct investment reduces, as few people or none want to invest in an economy with inflationary trends that are worrying. For instance, Zimbabwe in Africa has had fewer foreign direct investors, given the high level of domestic inflation witnessed in the country since the 1980s.

The other factor or variable was GDP. GDP increases with a corresponding increase in FDIs (Aziz & Mishra, 2016). This means that as a country's GDP increases, investors from the external environment would want to invest their capital in such countries to exploit the potential characterized by rising GDP (Aziz & Mishra, 2016). For instance, if the GDP is higher, then it means that consumption, domestic investment levels, planned and unplanned savings, and government expenditures are higher, which points to a stable and incentivized economy that can be used to encourage foreign investors (Azam & Lukman, 2010). The coefficient of GDP is 3.204960639, which is positive, implying that the higher the GDP, the greater the propensity of foreign investors to consider investing in a given country within the GCC region. Countries with higher GDP per capita have higher incomes and consumption. This means that an investor who considers investing in such a country can gain more customers, which translates to the revenues given.

On the other hand, we can also realize that the coefficient of the variable external balances vis-a-vis the FDI is a positive value of 0.178739729. This means that, as the external balance increases, the propensity for investors to consider and invest in a country increases. This means that the larger the external balance a country has in terms of capital inflows, the greater its propensity to attract foreign investors (Azam & Lukman, 2010). For instance, such countries can obtain capital given that they have greater exports than imports(X-I) (Sarno & Taylor, 1999). The greater level of foreign exchange suggests that capital flows can be used

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to lure and encourage investors from foreign countries and multinational companies to consider investing in the country to use that capital to produce more goods and services for export -hence encouraging an export-oriented or outward-looking strategy that the GCC countries have initiated in the past (Sarno & Taylor, 1999).

6. CONCLUSION

The main aim of this study is to explore the determinants of foreign direct investments in GCC countries. The explanatory variables are discussed, and the set hypotheses are answered. Given these results, we fail to reject the null hypotheses, given that the results of the regression show that none of the p-values are less than the chosen level of significance, which means that we do not reject the null hypothesis. We now say that there is a negative relationship between the inflation level of a given country and the level of foreign direct investment (Cheng & Kwan, 2000).

Again, there is a positive relationship between the trade level in the GCC and the level of foreign indirect investment. There is also a positive relationship between a country's GDP in the GCC region and its foreign direct investment level (Cheng & Kwan, 2000). Finally, the null hypothesis is not rejected for the fourth hypothesis, which implies that there is a positive relationship between external trade and the level of foreign direct investment of GCC countries in the GCC region.

The factors that are also important in determining foreign direct investments include political stability; factor endowments; comparative advantages in labor, capital, and resources; the rule of law; and a sustained level of economic growth (Cheng & Kwan, 2000). The data were collected through the World Bank website, and the models used were the fixed effects model, where the factors were fixed, and then their correlation and regression were computed and analyzed (World Bank, 2018).

6.1. Implications

This study implies that it also helps GCC countries, financial investors, policymakers, policy analysts, and governments of these countries to analyze, for instance, the element of risk that comes with political instability and economic risk such as inflation, recession, and fluctuations in the prices of fuels and other petroleum products (Chang, 2014). Countries that have uncertain political situations can be encouraged to study the foreign direct investment markets and environment to see the incentives that exist or not (Aziz & Mishra, 2016).

In many cases, countries that have instability, such as Russia and Ukraine, do not present a good opportunity for multination and foreign investors to venture into business in

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such regions. An economic crisis can also be studied as an implication for investors to analyze the business environment and decide whether to invest (Chakrabarti, 2001). For instance, in Russia, there is both an economic and political crisis resulting from sanctions, which creates a hostile environment that is not conducive for business (Amal et al., 2010).

The companies in the six countries of the GCC can learn lessons and implications from this study, and this is to be able to increase productivity of both labor and capital, and to increase per capita income and consumption of the citizens' increase, which is an indicator of economic growth and development (Amal et al., 2010). Countries can also invest by encouraging foreign investors and giving them incentives to enter the GCC region given the potential they have in terms of resources and petroleum for the country to increase tax revenues whenever they tax the investors; this also comes with increased government spending, planned and unplanned consumption, and internal investments as the FDIs influence both interest rates and exchange rates.

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