The Impact of Foreign Direct Investment on Economic Growth and Employment -Case of United Arab Emirates (UAE)-

أثر الاستثمار الأجنبي المباشر على النمو الاقتصادي والتشغيل -حالة الامارات العربية المتحدة-

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Abstract

The main objective of this study is to investigate the impact of Foreign Direct investment (FDI) on Economic Growth and Employment in United Arab Emirates (UAE), the study covering the period from 1980 to 2012. This study used Gross Domestic Product (GDP) as in dependent variable and also the employment level, whereas, the dependent variable is FDI. Based on descriptive analysis the study concludes that FDI dictate a positive relationship with GDP and so with the employment level. The study recommends making other research in the same field using more advanced statistical tool to get more accurate result and recommends transfer UAE experience in attracting FDI to other developing countries.

Keywords: *Foreign Direct investment, Economic Growth, Employment, Gross Domestic Product.*

الملخص

هدفت هذه الدراسة إلى تسليط الضوء على أهمية الإستثمار الأجنبي المباشر من حيث أشكاله ومفهومه وأهميته في الاقتصاد، كما هدفت من ناحية أخرى غلى تبيان أثر الإستثمار الأجنبي المباشر على النمو الإقتصادي والخلق مناصب الشغل في الامارات العربية المتحدة خلال الفترة الممتدة من 1980 إلى 2012 . واعتمدت الدراسة الناتج المحلي الاجمالي كمتغير مستقل لقياس النمو الاقتصادي وكذلك مستوى التشغيل، في حين اعتبرت حجم تدفق الاستثمار الأجنبي المباشر كمتغير تابع . خلصت الدراسة إلى وجود علاقة وطيدة بين المتغير التابع والمتغيرات المستقلة، حيث لتزايد تدفق الاستثمار الاجنبي المباشر الاثر الكبير في زيادة نسبة النمو الاقتصادي و كذلك التخفيف من حدة البطالة وخلق مناصب شغل جديدة خلال فترة الدراسة. وقد أوصت الدراسة بضرورة القيام بأبحاث اخرى على نفس المنوال مع الاعتماد على بيانات وبرامج احصائية حديثة لتأكيد هذه النتائج أو الوصول إلى نتائج اخرى اكثر دقة ، كما أوصت أيضا بضرورة نقل تجربة الإمارات العربية المتحدة إلى البلدان الأخرى للاستفادة منها.

الكلمات المفتاحية: الاستثمار الاجنبي المباشر، الإقتصاد، النمو الإقتصادي، البطالة، الناتج المحلي الاجمالي.

1. Introduction

Foreign direct investment (FDI) has become to be known as one of the most effective method of drawing flows from external sources. The use of this technique has also become a significant aspect of building capital in developing countries around the world. However, the share of investment from these countries in other states has been declining over the past years. For developing countries, the positive impact of foreign direct investment is becoming increasingly popular as a tool for economic growth and strengthening (Muhammad 2007). The most strongest positives of implementing FDI is the increase in aggregate productivity, increased opportunities of employment, greater outflow of exports and exchange of technological advancement between the investor and country. Having foreign direct investment in a developing country enables the employment and exploitation of natural and human resources, to implement innovative businesses practices, in terms of management and marketing, and facilitates in reduction of budget deficit. Another benefit of FDI is that it does involve the risks and regulations of external debt and adds value to the human capital through provision of on the job training. For countries that face a scarcity of capital and technological expertise usually experience growth slower than those that do. According to a number of studies, foreign direct investment can serve as a means of transfer of technology and knowledge (Dunning & Hamdani 1997). Conversely, some other studies (e.g. Schoors et al., 2002) suggest that FDI can have negative impact on domestic economies. Repatriation of profit and “market stealing effect” are good examples discussed in this study.

In this study we are focusing our research on the effect of FDI on economic growth and employment in United Arab Emirates. Now, we can ask why did a need arise among the researchers to choose UAE and not other countries? The answer to this comes from the qualitative leap that occurred in the UAE economy in the past few years, where UAE considered as one of the most developing countries in the Gulf Cooperation Council GCC.

1-1 Objectives of the study

The main objective of this study is to find the effect of Foreign Direct Investment on economic growth and employment in United Arab Emirates UAE.

1-2 Importance of the Study:

On one hand, the importance of this study stems from the lack of empirical studies that have previously conducted in this country, because the majority of studies on this field have been conducted on the developed market rather than on the emerging market. On the other hand, this study may help the regulator to improve the investment climate to attract more foreign investors.

1-3 Question of the Study:

To find out the effect of FDI on the economic growth and employment, the study considers the following questions:

- To what extent we can use the FDI to predict the economic growth and employment in UAE?
- Is there a relationship between the economic growth and FDI in UAE?
- What are the economic variables can we use to measure the economic growth?

1-4: Research Hypotheses:

H_1: there is relationship between FDI, economic growth, employment level in UAE.

H_0: there is no relationship between FDI, economic growth, employment level in UAE.

1-5: Methodology of the Study:

This study is based on a descriptive and analytical approach.

2. Theoretical Background and Literature Review

2.1 Main Concepts:

❖ **Foreign Direct Investment (FDI):**

Numerous definitions for foreign direct investment presented, which was defined as "those investments managed by foreigners; because of its full ownership, or ruling over them to share justify their right of management, most of these investments are made by multinational companies." **(Lotfi, 2009).**

According to the International Monetary Fund, foreign direct investment, commonly known as FDI, "refers to an investment made to acquire lasting or long-term interest in enterprises operating outside of the economy of the investor." The investment is direct because the investor, which could be a foreign person, company or group of entities, is seeking to control, manage, or have significant influence over the foreign enterprise.

The WTO (World Trade Organization) and the Organization for Economic Cooperation and Development defined the foreign direct investment as: "any investment activity is stable in a particular country (country of origin), which owns assets in another country (the host country), in order to conduct these investments." **(Bassam, 2011)**

❖ **Economic Growth:**

Is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time it is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP**. (IMF,2012)**

Of more importance is the growth of the ratio of GDP to population (GDP per capita, which is also called per capita income). An increase in growth caused by more efficient use of inputs (such as labor, physical capital, energy or materials) is referred to as intensive growth. GDP growth caused only by increases in the amount of inputs available for use (increased population, new territory) is called extensive growth**. (Bjork, Gordon J. (1999).**

❖ **Full Employment:**

Full employment, in macroeconomics, is the level of employment rates where there is no cyclical or deficient-demand unemployment. ***(*Sullivan et al., 2003).**

The 20th century British economist William Beveridge stated that an unemployment rate of 3% was full employment. For the United States, economist William T. Dickens found that full-employment unemployment rate varied a lot over time but equaled about 5.5 percent of the civilian labor force during the 2000s.[1]

2.2 Literature Reviw

Alfaro (2003): Foreign Direct Investment and Growth: Does the Sector Matter?

The study aimed to investigate the effect of foreign direct investment on growth in host countries. The study examined in the primary, manufacturing, and services sectors. Moreover, an empirical analysis using cross-countries data for the period 1981-1999 was made. The results show that total FDI has an ambiguous effect on growth. However, a negatively impact of investment in the primary sector on growth is also detected.

Katerina et al., (2004): Foreign Direct Investment and Economic Growth in Transition Economies

The majority of studies investigate the relationship between FDI and the economic growth in US and European countries. Yet, the main objective of this study is to examine and find out the relationship between the foreign direct economic and growth in transition economic. The study employs bayesian analysis. The results indicate that foreign direct investment doesn't show any significant relationship with economic growth for all these countries.

Abdulkhaliq (2007): Foreign Direct Investment and Economic Growth: Empirical Evidence from Sectoral Data in Indonesia

The purpose of this study is to find out the impact of foreign direct investment (FDI) on economic growth using detailed sectoral data for FDI inflows to Indonesia over the period 1997-2006. In whole, FDI is detected to have a positive impact on economic growth. Conversely, the results show no effect one accounting for the different average growth performance across sector.

Gudaro et al., (2012): Impact of Foreign Direct Investment on Economic Growth:A Case Study of Pakistan

The paper aimed to analyze the effect of FDI in Pakistan for the period 1981 to 2010. The study tries to link between Gross Domestic Product (GDP) from one part and foreign direct investment FDI and Inflation from other part, where GDP is considered as dependent variable. Whereas FDI, and Inflation (CPI) are considered as independent variables. According to the results, the model is significant with the positive and significant association of GDP and FDI while a negative and significant relationship detected between GDP and inflation.

Tshepo (2014): The Impact of Foreign Direct Investment on Economic Growth and Employment in South Africa: A Time Series Analysis

The paper attempts to find the impact of FDI on economic growth and employment in South Africa covered the period of 24 years from 1990 to 2013. The study used the unit root test to examine for stationarity of time series. Moreover, the johansen Cointegration test is employed to test the existence of long-run relationship between variables. The results of analysis show that employment and FDI were found to be stationary at first order difference .However, FDI is found stationary at level form, in whole the results detect strong evidence that from 1990 to 2013 there was a positive long-run relationship between FDI, GDP and employment in South Africa.

Trinh and Nguyen (2015): The Impact of Foreign Direct Investment on Economic Growth:Evidence from Vietnam

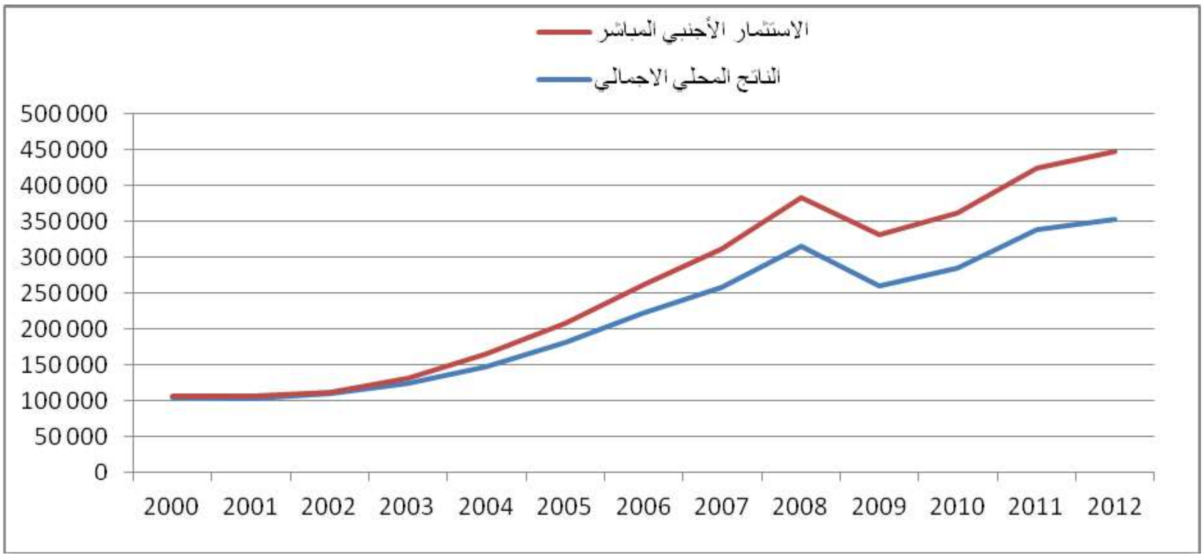
The study aimed to investigate the impact of FDI inflows on economic growth in Vietnam over the period from 1990 to 2013 employing time series analysis technique. The empirical result dictate that FDI inflows, domestic investment, found to have a negative influence on economic growth. Additionally, the effect of government consumption on economic growth is negative.

3. The State of Foreign Direct Investment in United Arab Emirates

Most of the nations of the world seek to get high rates of economic growth, so as to pursue different policies that lead to this goal. Where the United Arab Emirates has focused on attracting foreign direct investment to move its economy and diversify the production base. Foreign direct investment has been taken as considerable by the United Arab Emirates government.

1. The relationship between Foreign direct investment and GDP in UAE

The following figure illustrates the relationship of foreign direct investment to GDP in the United Arab Emirates during the period (2000-2012).

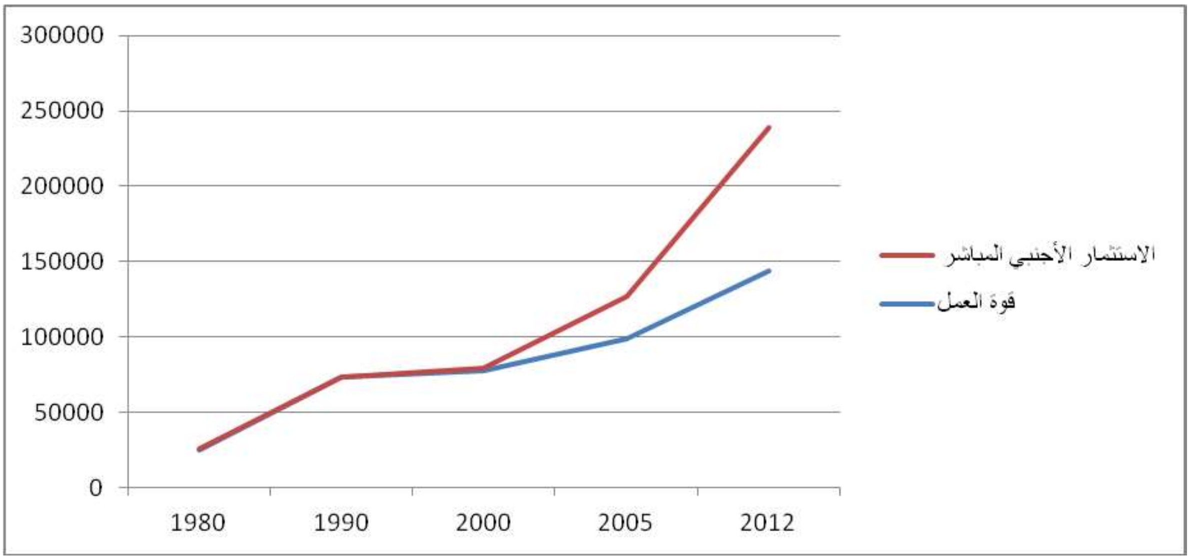


Source: UNCTAD, Statistics Database Online

As can be seen from the previous figure, foreign direct investment in the United Arab Emirates is linked positively with GDP, we notice that the rise in foreign direct investment during the period (2000-2012), led to an increase in GDP.

It also indicates that increase in flow of FDI during the given period in Emirates show the ability of UAE to maintain its attractiveness, and its continuance, to provide services that make up the major factor attracting investment flows, pumping more capital into major projects, which have benefitted GDP and raise it up.

Moreover, the United Arab Emirates is seeking for foreign direct investment to contribute the reduction of unemployment, since the presence of the multinational companies help to increase employment opportunities, also has a significant role in the rehabilitation and development of the national labor, leaving them unable to compete in the domestic and global market. The figure below illustrates the correlation of foreign direct investment with the development work in the United Arab Emirates strength.



Source: UNCTAD, Statistics Database Online

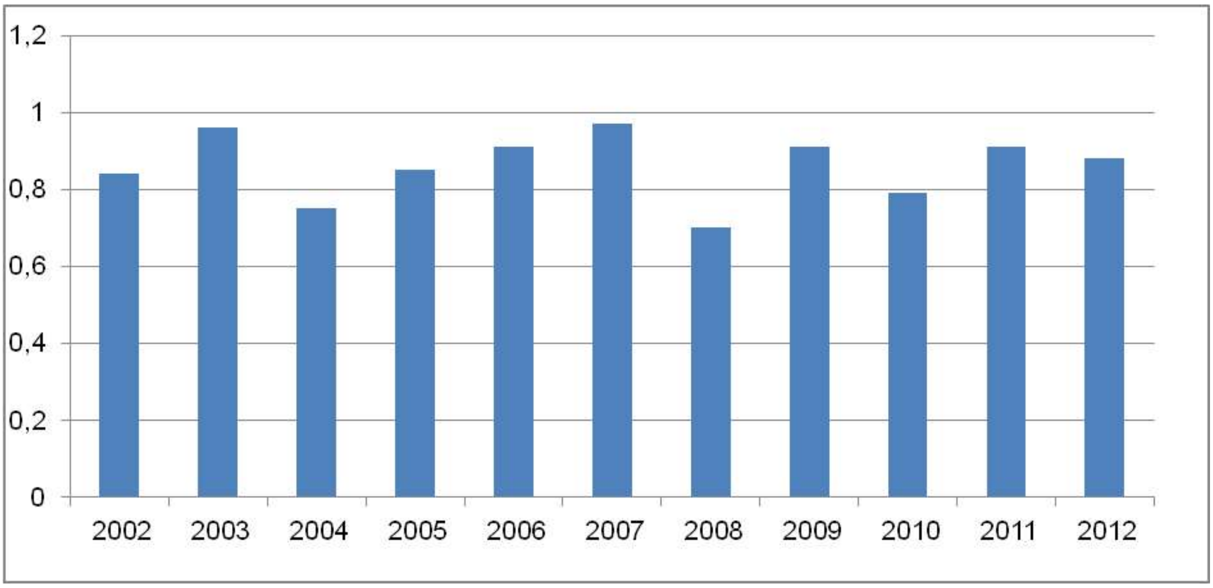
We notice from the table above the relationship between the FDI and Labor Forces in United Arab Emirates during the period specified. We conclude that as the increase in presence of multinational companies; have contributed to reduce unemployment in (1980-1990-2000) dramatically.

It is also noted in (2000-2012), that the flow of FDI continues to rise, but the labor force is high, but is lighter in general (2005-2012); and indicates that multinational companies not able to absorb the surplus of unemployment, the employment rate of large unemployed.

During this specific period, Emirates has a high unemployment rate, due to the large dependence on foreign labor, making multinational corporations are not able to absorb all the unemployed and employed.

2. The investment climate in the United Arab Emirates:

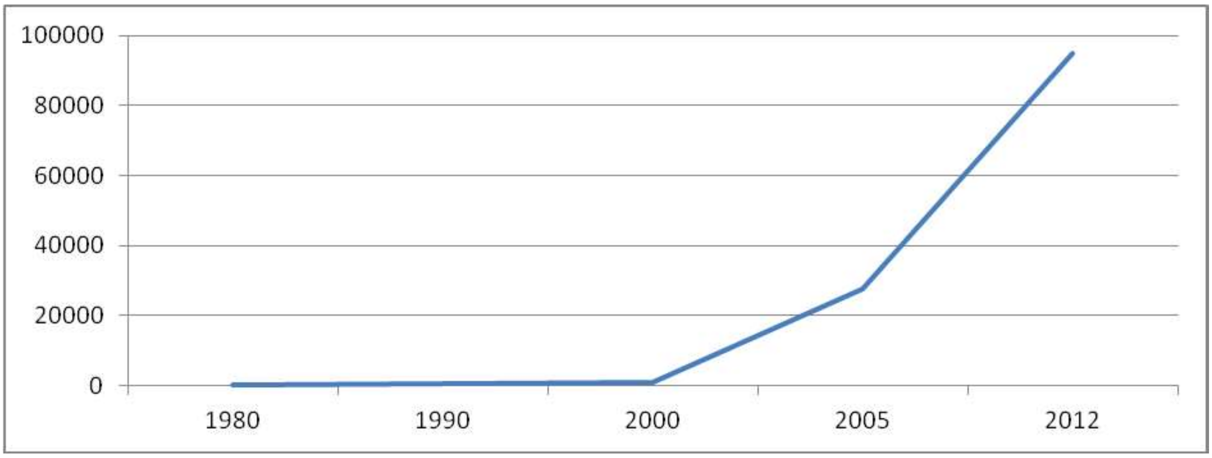
The security, political and economic stability that United Arab Emirates characterized by, is one of the biggest factors that led to the foreign investor attraction. And also international conventions held by the Emirates, whether regional or international, such as the entry as a member of the World Trade Organization, which facilitated the movement of capital between member states. The figure below illustrates the political stability in UAE during the period (2002-2012).



Source: World Bank, World governess Indicators, Database Online

We notice from the previous table that the Emirates during the period (2002-2012), has characterized by political stability, as this stability did not come from a vacuum, but they have the ingredients that make the safety case and stability, through Emirates wise government efforts, which on interaction permanently and continuously with their citizens, as this political stability making it among the first in attracting foreign investors.

3. Evolution of FDI inflows in the United Arab Emirates during the period (1980-2012):



Source: UNCTAD, Statistics Database Online

We notice from the previous figure that, foreign direct investment has been increased, following the progress and development achieved by the United Arab Emirates during those years. And all these factors have led to an increase the flow of foreign investment. Thus, make UAE the first country for attracting foreign investors. It is clear from the previous figure, that in 2005, total foreign direct investment was $ 27 million, and then jumped up to $ 95 million in 2012.

In addition to the foreign investor in the UAE can invest in many sectors, both the real estate sector, the service sector and the manufacturing sector, and also in the financial institutions, and others. The table below shows the evolution of foreign direct investment in the United Arab Emirates by economic activity during the period (2007-2011).

4. Results and Recommendations

This study aimed to investigate the impact of FDI on economic growth during the period from 2000 to 2012, based on the hypotheses which assume that the FDI positively affect the economic growth. The study considered an analytical and descriptive method to find out the relationship.

The study concluded that FDI has a positive impact on economic growth in UAE, which could bring new technology create jobs, and contributes in reducing unemployment.

Therefore, Emirates has provided many facilities and incentives to attract more foreign investment, as we see in the previous figures. Moreover, this increasing in FDI led to an increase in the GDP in UAE and also the economic growth.

Based on the previous results the study recommends the following:

- The study recommends the encouragement of foreign direct investment in sectors that have high export capacity, such as the manufacturing sector, so as to reduce the UAE's dependence on oil revenues and the same for all developing countries.
- The study recommends the focus on the development of infrastructure, and the development of large-scale projects to bring prestige to the UAE, which contributes to the increase in attracting foreign direct investment.
- The study suggests doing more research on the topic of foreign direct investment, in the United Arab Emirates, and assessing the extent of benefit from foreign direct investment by highlighting other economic indicators such as its impact on exports, and other indicators.
- The study recommends using advanced standard methods, in order to prove the validity of the results.
- The study recommends using indicators at constant prices, in order to get more accurate results.
- The study recommends the regulators and responsible in Algeria considering the United Arab Emirates as a Successful model in attracting FDI, and apply it in reality to improve the investment climate.

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