THE ROLE OF FOREIGN DIRECT INVESTMENT IN ENHANCING THE PRODUCTIVITY OF OMANI MANUFACTURING FIRMS

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THE ROLE OF FOREIGN DIRECT INVESTMENT IN ENHANCING THE PRODUCTIVITY OF OMANI MANUFACTURING FIRMS

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Abstract

This study examines the effect of foreign direct investment (FDI) on the productivity of local manufacturing firms in Oman. By distinguishing patterns in spillover effects according to their channel, mechanism, and preconditional factors, the thesis explains why rentier states like Oman have failed to utilise FDI as a tool to enhance their private sectors despite having made huge strides in improving their business environment. It is argued that this limited success is due to a passive government role, weak absorptive capacity, and a preference amongst Omani nationals to work in the public rather than private sector. Through primary mixed methods research, comprising a case study research design and mixed methods (42 semi-structured interviews and a survey of foreign, joint venture and local companies in Oman (n=96), the study finds that the impact of FDI on the development of the Omani private sector is very limited, mainly because of the overwhelming political and economic environment and rentier structure of Oman. Based on these findings the research suggests ways in which oil-producing countries can circumvent some of the negative consequences of rentierism and increase their local companies’ productivity. To this end, clear recommendations are provided for policymaking, as well as domestic and foreign investors. This study extends the existing literature on FDI spillovers to a previously unstudied region, (GCC countries) and to an economic model (rentier states) to which it has not previously been applied. This study fills a gap in global knowledge about productivity spillovers in countries which have a unique economic structure where the government is dominant in all economic activities and local human resources are mostly not engaged in domestic firms, which rely mainly on expatriates.
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The thesis is dedicated to my country, the Sultanate of Oman, to which I hope I can apply some of the ideas presented here, to solve some of its economic challenges.
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Abbreviations

ACAP: Absorptive capacity
BOP: Balance of Payment
CBO: Central Bank of Oman
EOR: Enhanced Oil Recovery
ESCWA: The Economic and Social Commission for Western Asia
FD: Financial Derivatives
FDI: Foreign Direct Investment
FPI: Foreign Portfolio Investment
IIP: International Investment Position
IMF: International Monetary Fund
LCR: Local Content Requirement
LDCs: Local Domestic companies
LNG: Liquefied Natural Gas
M& As: Mergers and Acquisitions
MNC: Multinational Corporation
MOCI: Ministry of Commerce and Industry
MONE: Omani Ministry of National Economy
OECD: The Organisation for Economic Co-operation and Development
OFI: Other Foreign Investments
PAIPED: Public Authority for Investment Promotion & Export Development
PDO: Petroleum Development Oman
PEIE: Public Establishment for Industrial Estates
RST           Rentier state theory
RO:           Rial Omani
SBSRs         State, business and society relations
SCP:          Supreme Council for Planning
SMEs:         Small and Medium Enterprises
SOEs:         State Owned Enterprises
SWFs:         Sovereign Wealth Funds
TNC:          Transnational Corporations
UNCTAD: United Nations Conference on Trade and Development
UNDP:         United Nation Development Programme
WB:           World Bank
Introduction

In the 1960s and the early 1970s, most developing countries believed that FDI was a threat to their wealth and hindered their economic development.¹ Some of these countries saw Multinational Corporations (MNCs) as a continuation of their colonial past, which naturally resulted in dislike, and distrust of FDI. However, according to the United Nations Conference on Trade and Development (UNCTAD) during the last three decades, views of FDI are changing. The flow of FDI between countries has become recognized as one of the benefits of global trade, and thus many countries are now liberalizing their markets and competing to attract more FDI.² Yet debates continue in a variety of academic literature over the viability of foreign investments and the role of MNCs in promoting domestic business and economic development.³ Indeed, further research is called for given the changing nature of FDI, in terms of both volume and type, and important changes in source and destination countries.⁴

This dissertation empirically examines the role of FDI in enhancing the productivity of the domestic private manufacturing sector in oil-producing countries, using Oman as case study. In doing so, this research will help fill a gap in the literature which largely ignores a class of cases, often referred to as “rentier states.” These are states that derive all or a substantial portion of their national revenues from rent of indigenous resources to external clients. The oil-rich countries of the Gulf Cooperation Council (GCC), including Oman, are common examples of these types of economies.⁵ In doing so, this research will

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² Both developed and developing countries.
⁴ Similarly, Fan calls for a more rigorous theoretical analysis because FDI has not been given an important role in the growth literature. Fan Emma Xiaogin (2002), Technological Spillovers from Foreign Direct Investment- A Survey, ERD, Working paper No.33, Asian Development Bank.
⁵ Babalwi and Luciani (1990)
also develop better public policy for oil producing countries in general, and these often overlooked rentier states in particular.

As illustrated in Figure 0.1, the ultimate objective for any given economy is to reach sustainable development. According to previous studies, there are two main ways to achieve this objective. One is through diversifying the outcomes through producing new products and services and searching for new market. However this requires a high degree of innovation and higher absorptive capacity that available in developed economy. The second way of achieving sustainable development is diversifying the income resources with both government and private sector playing essential roles. This approach is applicable to developing countries. Here, the government’s role is mainly limited to preparing the business environment through regulations. Thus, the real actor in reaching sustainable development in developing countries is the private sector.

The literature identifies many ways to develop and enhance the efficiency of the private sector for contributing to sustainable development. Central among them is the use of FDI through multinational platform MNCs. During the last three decades, there has been a remarkable growth in global FDI. As a result, the number of foreign affiliates has increased rapidly, and many governments of developing and developed countries are competing to attract FDI. This is evident in the different incentive schemes and investment promotion agencies that many countries have put in place. The promotion of FDI has thus become an important component of most national development strategies to achieve sustainable development targets and prosperity.

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6 The United Nations Conference on Sustainable Development.
8 Two types of incentive schemes are repeatedly adopted. The first one where governments focus on improving their countries through improving their institutions, improving human capital development through education and training, as well as infrastructural development. The second approach is through fiscal and financial incentives such as tax holidays, duty drawbacks, grants in aid, investment allowances, and exemptions from environmental standards.
Such development strategies aim to benefit from a range of spillover channels between MNCs and local companies.\textsuperscript{9} These include: technology, which leads to enhanced production; management, which leads to better control on time and quality; marketing techniques, which leads to increased exports; capital, which leads to more investment; best practice; and skill, which raises labour productivity and competition resulting in improved efficiency in the domestic market. Benefiting from spillover through these channels should result in strengthened domestic companies, economic diversification and the promotion of sustainable development.\textsuperscript{10}

However, these spillover benefits do not accrue automatically and should not be taken for granted.\textsuperscript{11} MNCs do not simply hand over the source of their advantage.\textsuperscript{12} In order to benefit successfully from spillovers, the host economy needs to prepare the ground through well-designed and implemented policies.\textsuperscript{13} To ensure that a win-win situation is achieved, all stakeholders, particularly government, private sector and MNCs, must participate and collaborate to recognize and tackle typical barriers or constraints to spillovers. This may involve strengthening absorptive capacity, narrowing the technology gap, and making a trained and qualified local labour force. It may also involve enhancing forward and backward linkages, institutional framework, and linkages between FDI and domestic firms.

\textsuperscript{9} Buckley Peter J., Wangb Chengqi, Clegg Jeremy(2007), The impact of foreign ownership, local ownership and industry characteristics on spillover benefits from foreign direct investment in China, Centre for International Business, International Business Review 16, 142–158; P.142.


\textsuperscript{12} MNCs can reached that by proper protection of intellectual property, trade secrecy, increase wages to reduce labour turnover, or locating in countries or industries where domestic companies have limited capacity to copy products or services. (NB first part of this footnote ‘reached that’ is unclear.

Aims and Objectives of the Research

The aim of this research is to examine the impact of FDI in enhancing the productivity of the domestic manufacturing sector in oil-producing countries. To this end, the following specific objectives are set:

- To examine the spillover effects of FDI on the domestic firms through various possible channels that might benefiting the host market from international market by MNCs that might boost productivity in the host economy firms. In doing so, the mechanisms of that transmit these potential effects will be examined, including business linkages, labour mobility, competition and demonstration effects.

- To examine how the conditions of host economy affect the extent of the

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14 See figure 0.2
15 For instance: new technology, marketing techniques, management skills, capital, employment, export enhancement, diversification of economy and increased competition resulting in improved efficiency of domestic market.
16 These include, backward, forward, vertical and horizontal linkages and technology partner.
17 When MNCs provide training and work experience to local workers who then move and apply their knowledge in the local companies or start their own business.
18 Including imitation or reverse engineering.
productivity spillovers from FDI. These include the host economy’s absorptive capacity, intellectual property rights, ownership structure, and MNC motives.

- To assess the effectiveness of policy instruments and platforms in the Omani economy in achieving the objectives mentioned above.

**Figure 0.2: FDI and the Private Sector Interaction Components based on literature**

![Diagram showing FDI and private sector interaction components]

- **Research Questions**

  The aim of this research is to examine the role of FDI in enhancing the productivity of domestic firms in the manufacturing sector in Oman. Thus the main research question is:

  ‘To what extent has FDI enhanced the productivity of domestic manufacturing firms in Oman?’

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19 This includes the technology gap, institutional framework, and the extent of a trained and qualified local labour force.

In order to obtain the required data for answering this research question, sub-questions are formed to arrive at a conclusion. The questions will be answered under two main dimensions, first, concerning the productivity of spillover effects and second, concerning the effectiveness of government policies in facilitating spill over:

**A. Examine the role in enhancing productivity spillovers**

1. How has FDI affected the productivity of domestic firms in the manufacturing sector in Oman?
2. What are the specific factors to be considered in enhancing the productivity spillovers?

**B. Examine the effectiveness of policy instruments and programmes:**

3. Have current policy instruments resulted in enhanced productivity spillovers?
4. What policies should Oman learn and adopt to capture the benefits from FDI and avoid the negative impact?

**Contributions of the Research**

This research may contribute to the debate around FDI at several levels. First, much empirical and theoretical research has been undertaken in the area of using FDI to enhance private sector development in industrial countries, Latin American countries, Asian and less developed countries. Yet surprisingly there has been little research on FDI interactions with the private sector of the host country in developing countries. Moreover, to the best of my knowledge, this is the first study on FDI spillover in Oman. Thus this research seeks to make original contributions to knowledge in the field and act as a platform on which other research can be built.

Second, this research can inform public policy in Oman and similar countries by highlighting how FDI can be used as a means to support and enhance the private sector in host economies. As the process of economic globalization marks the decline of national markets and the rise of global markets, this implies a need for oil producing economies to adapt their FDI policy agenda.
Third, this research examines for the first time a vital element called an Investment Map, which will help in monitoring FDI to reach a win-win situation for both FDI investors and the host economy.

Fourth, this research will help other countries of similar structure, such as the Gulf region economies and other oil producers, and will provide good input to academic study.

Fifth, this research contributes to Rentier State Theory (RST) by empirically examining how FDI functions in these types of economies.

Sixth, this research provides documentation for the political factors that impact FDI, a topic that previous scholars have neglected.21

Case Selection

Oman has been chosen as a case to study because it has been engaged in rapid change. Starting with the commercial exploitation of oil in the late sixties,22 the nation quickly became an oil-exporting economy.23 However, Oman soon faced two main challenges: the limited oil reserves and the geology which increased the cost of oil extraction, narrowing the profit margin relative to other GCC countries. Oman is combating these challenges by pioneering the Enhanced Oil Recovery (EOR) method of extraction. As in other oil-producing economies, development favoured this sector,24 neglecting other traditional sectors where the country has comparatively less advantage in the development.25 In addition, Oman’s national savings are much lower than its


22 Valeri,(2014),p72

23 In terms of a high dependency on hydrocarbons as expressed by share in oil and gas revenues from export and the share of the Hydrocarbon sector in GDP.

24 Dutch disease: negative consequences arising from large increases in a country’s income. It is primarily associated with a natural resource discovery. The end result is that non-resource industries are hurt by the increase in wealth generated by the resource-based industries.

25 Tourism, Fisheries and Agriculture.
domestic investment demand. Hence it needs to create an appropriate domestic environment to attract more FDI to fill its saving-investment gap.\textsuperscript{26}

Moreover, the private sector was encouraged by the Omani Government to take off and help the public sector in terms of creating adequate employment opportunities,\textsuperscript{27} funding economic development projects and promoting economic diversification.\textsuperscript{28} FDI has great potential to support and enhance the economy, particularly in the domestic private sector, and subsequently add value to long-term development.\textsuperscript{29} Oman has several advantages that make it an attractive destination for FDI. In order to diversify its economy and develop the private sector,\textsuperscript{30} Oman has actively sought to attract FDI through investment incentives, streamlining and simplifying the legal and regulatory frameworks, and providing a favourable tax regime.\textsuperscript{31} In fact, the Omani economy is passing through a favourable stage that may not last for long.\textsuperscript{32} The economy is benefiting from the outcomes of large investments carried out by the government in the fields of infrastructure including roads, ports, and logistic facilities.\textsuperscript{33} The government has further concluded several international and regional agreements.\textsuperscript{34} Oman is a member of a number of multilateral agreements and International and regional organizations, and has a number of bilateral agreements\textsuperscript{35} with an A+ rating from some recognized rating

\textsuperscript{26} Mansur Ahsan and Treichel Volker (1999). Oman Beyond the oil Horizon Policies Toward Sustainable Growth, International Monetary Fund, Washington DC, P 18.


\textsuperscript{31} World Bank (2004).


\textsuperscript{33} Ministry of National Economy (2009), Statistical Year Book various issues, Sultanate of Oman.

\textsuperscript{34} Oman, 2008.

\textsuperscript{35} The Sultanate Of Oman In World Competitiveness, An Exclusive Report Specially Prepared for Ministry of National Economy, IMD, September 2009
All these can be best utilized for the benefit of the country, particularly regarding FDI.\textsuperscript{37}

The manufacturing sector has been chosen as the focus of this research because it is centrally important to Oman’s non-hydrocarbon economy. The large size of the sector and its capacity to expand make it the site of great potential for economic growth that would move Oman away from the rentier model. It contains a large number of SMEs with development potential. In terms of the number of firms officially registered in Oman, the manufacturing sector comes second, accounting for 20 percent of total firms, after the wholesale and retail trade sector, which account for 47 percent of total firms.\textsuperscript{38}

The potential of the manufacturing sector is reflected in the Omani government’s own development vision, which has two elements. One is diversification of the economic base from the hydrocarbon sector to allow manufacturing a more significant role. Two is increasing the role of private sector as an engine of growth in Oman through liberalizing the economy. The idea is that liberalizing the economy will enhance non-oil exports and attract more FDI to Oman and spillover effects to local private sector. In this regard, the “Vision 2020” economic plan seeks to grow the share of manufacturing in GDP from 5 percent in 1995 to 15 percent by 2020. The hope is that the manufacturing sector’s huge potential for growth will develop and diversify the Omani economy, and generate jobs for a young and growing population.

- The Omani government is investing heavily for manufacturing in developing new industrial areas and free zones. Three free zones and a Special Economic Zone have been developed in Oman. The free zones are: Al Mazunah Free Zone, strategically located in the south west of Oman on the Oman and Yemen border; Sohar Free Zone, which encompasses a serious centre of manufacturing with low investment and highest possible added value; Salalah Free

\textsuperscript{36} Ministry of Information (2014), Oman 2013-2014


\textsuperscript{38} The wholesale and retail firms were not the focus of the study because they not ripe for development and they indirectly rely on oil money for their success.
Zone, which is located in a globally strategic location with access to Europe, Asia, Africa and Australia. Besides access to some of the world’s fastest growing markets, the zone also offers a whole host of other business advantages, such as Duqm Special Economic Zone, which is located directly on the Arabian Sea, 500km south of Muscat, has the second largest dry dock in the Middle East and is operated through joint venture with Daewoo and of the Oman government. The area of the zone is 1,777 km² and it is planned to be the largest in the Middle East.

- In terms of FDI attraction, manufacturing comes second after oil and gas in terms of the volume of FDI in average of the last 10 years. \(^\text{39}\)
- The scope of productivity spillovers is huge in the manufacturing sector compared with others because of the new technology and dynamic production techniques that are available from MNCs which can spill over to the Omani manufacturing sector.
- In regional terms, GCC countries aim to establish a huge industrial base economy which gives a signal for Oman to focus on this area.
- On global level trend and pattern of FDI UNCTAD reports confirm that the manufacturing sector is growing globally very fast and is the focus of the majority of countries particularly in GCC countries.

**Methodology and Design of the Research**

A mixed-method research design is used, incorporating quantitative and qualitative primary data collection, along with extensive use of secondary data such as official statistics from the Omani government. This design is deployed in order to explore the experiences of key stakeholders in the spillover process, and document their views on its effectiveness in benefiting the local manufacturing sector, as well as the effectiveness of Omani government in facilitating that process.

\(^{39}\) Oil and Gas sector not been chosen because not helping to diversify the economic base of Oman and the limited reserve are declining.
One aspect of the study was explorative, creating new documented information for a topic with little literature. Semi-structured interviews allowed respondents to describe their experiences in their own terms, whilst retaining a common core of questions so that their responses could be compared with other participants in the study. The survey allowed for quantitative data to be generated, which enabled generalisations to be made about the views of key stakeholder groups with regard to the relationship of FDI and spillovers for the local manufacturing sector.

The questionnaire and interviews conducted for the collection of primary data were divided into two parts. Part one was designed to answer those questions related to the achievement of the macro objectives of private sector development. Part two was designed to answer those questions and hypotheses related to the effectiveness of policy instruments and programmes used by governments to attract and monitor FDI in Oman. This primary data is used to document the perceptions of key stakeholders regarding FDI and spillover to the local manufacturing sector in Oman.

However this data is inherently limited in what it describes. Data about perceptions alone, whether quantitative or qualitative, cannot satisfactorily address questions regarding how much FDI there has been in Oman in any given period. Nor can it address the extent to which government policies may have effected levels of FDI or its spillovers. These are questions best addressed through official statistics, that is, secondary data gathered by the government of Oman and its agencies and a variety of independent monitoring agencies. For this reason, this study supplements the interview and survey data with official statistics.

**Survey**

The survey was conducted in the Sultanate of Oman during the second year of the study. A questionnaire was distributed to 150 manufacturing firms that include 30 percent from various economic sectors. At the end of the questionnaire, space was provided for respondents to make additional
comments about benchmarks or best practices derived from experiences of other countries, which benefited from FDI to formulate business linkages with domestic enterprises.

The questionnaire consisted of six sections. "Section A" aimed to collect general information regarding the respondent’s situation, such as occupation, economic activity, ownership structure and business environment. "Section B" aimed to explain how MNCs influence the upgrading of domestic enterprises through spillover channels and mechanisms. "Section C" aimed to deal with precondition factors for example, absorptive capacity, institutional framework and mode of entry or ownership. "Section D" aimed to focus on public policies, strategies and incentives. "Section E" called for a SWOT analysis for the Omani business environment in relation to attracting FDI and formulating business linkages with domestic enterprises.

**Semi-structured interviews**

To explore the phenomena under investigation, I engaged in substantial fieldwork in 2013, carrying out face-to-face interviews with 42 representatives from the three categories of policymakers in the government, local investors and foreign investors. The interviews were conducted between June and September 2013, and ranged from 30 to 70 minutes in length. The selection of the interviewees was based on a snowball technique in which one interviewee nominates another, and so on. The governmental institutions were chosen based on various criteria, including their direct relation with FDI and private sector development, whether attract, regulate or/and support. All interviews were recorded.

The central focus of the interviews was theoretical concepts about the FDI, private sector and other factors that are important for spillover effects. Furthermore, the interviews captured perceptions of the relations between local and foreign enterprises, which can provide even more valuable information than quantitative investigations, where only a static picture is drawn. With a qualitative approach, it is possible to acquire insights into processes, expectations and perceptions about the relations between domestic and
multinational companies in the Omani economy. Therefore, interviews were used in this study to validate the questionnaire findings and to go deeper to collect additional needed information.

Secondary data sources

The following data sources were used to answer the questions of this research: FDI survey, production survey industrial statistical survey, foreign trade data, taxation data, Balance of Payment (BOP) and International Investment Position (IIP) data and others, reports and online resources of UNCTAD, the International Monetary Fund (IMF), the Economic and Social Commission for Western Asia (ESCWA), The Organisation for Economic Co-operation and Development (OECD), the World Bank (WB) and other international agencies.

Scope of the Research

This study is limited to FDI only and did not investigate the study objectives with reference to other types of foreign investment such as Foreign Portfolio Investment (FPI), Financial Derivatives (FD) and other Foreign Investments (OFI) in any way. Although FDI creates economy-wide effects, the main focus of this study is limited to the influence over the local Manufacturing firms, in particular to evaluate the changes in productivity and the potential spillover effects occurring from the MNCs activities in an oil economy. However, the topic of MNCs activities and capital was not of key importance in this study. Inward FDI in Oman is analysed in this case and outward FDI is not covered, keeping the Sultanate of Oman as the specific focus. During the analysis, a period from 2002 to 2011 was covered, once again focusing only on FDI and private sector relationships and did not cover other aspects of FDI. The scope of the study was narrowly defined in order to focus the efforts while meeting word and time constraints so as to make the study feasible.

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40 Navaretti, Giorgio Barbra & Venables, Anthony J. (2004), Multinational Firms in the World Economy; Princeton University Press.
41 MNCs and local firms interact in a different of ways. They directly compete in product and factor markets. Also, they can trade with each other by supplying inputs or exchanging technology. Additionally, when there is non-market interaction between firms-externalities.
Thesis Outline and Structure

In achieving the research aims and objectives, the thesis comprises eight chapters in addition to the introduction, as follows:

Introduction: develop the central focus of the research which provides an overview of the research, aims and objectives, questions, rationale of study, research methodology, the layout and limitations of the research.

Chapter 1 reviews the literature to lay the foundation and cover some historical aspects of the interactions between FDI and the private sector. The chapter is divided into two sections. First, rentier state theory (RST) is discussed, emphasizing institution and state-business-society relationships in countries like Oman. Second, historical aspects of FDI and private sector interactions are described, emphasizing the possible spillover effects between MNCs and the local economy.

Chapter 2 provides detailed analysis of FDI trends and its distribution in the world, also shedding light on the trend of policy change, FDI direction, sources, modes of entry, industry and components. The analysis focused on GCC countries. In addition, it provides a clear picture of FDI trends in Oman. Components, sources, geographical distribution and FDI profitability. Also, it covers the business environment by describing many relevant dimensions of the business environment in rentier countries, including a variety of Omani policy initiatives that have been used to attract FDI and enhance productivity spillovers to the domestic economy.

Chapter 3 critically evaluates the prospects for FDI in Oman by analyzing the political and economic factors that shape the country’s business environment. The chapter will provide in-depth analysis and understanding of the current Omani economy and the private sector, strengths and weaknesses, challenges and support needed for growth and related expectations. It will provide facts and figures in-line with the research objectives and how FDI can be one of the most important instruments for the enhancement of the private sector with particular focus in manufacturing sector.
Chapter 4 lays out the detail of procedures and methods followed in the research, including data collection for the study. Furthermore, it also justifies the techniques that were used in achieving the research objectives, including mixed methods, sampling methods, sampling size and the pilot study. It also provides an explanation of methods of analysis, validity and reliability, the location of the study and the limitations of the methodology.

Chapter 5 analyses and presents the findings of the survey data which will ultimately answer the research question. It presents descriptive statistics (means and percentages) and uses graphs, charts and tables, to facilitate understanding of the results. The results for selected questions are broken down according to key variables such as the nature of the business from which the respondent comes (foreign owned, joint venture, locally owned).

Chapter 6 analyses the semi-structured interviews, presented using thematic analysis. The main themes are presented using illustrative verbatim quotes from the interviews. This begins by exploring the interviewees' opinions about FDI, particularly its impact on domestic firms. This is followed by an analysis of the interviewees' views on the spillover effects and policies needed to facilitate spillover. This sheds light on the findings of the Omani business environment in relation to attracting FDI and formulating business linkages with domestic enterprises through the use of SWOT analysis.

Chapter 7 brings together the findings from previous chapters and relates them to previous studies and the theoretical body of knowledge. The chapter focuses on discussing research findings in relation to the business environment and the overall economic impact of FDI in Oman. The includes productivity spillovers, preconditional factors for productivity spillovers, and the effectiveness of policy instruments and platforms to achieve high productivity levels in domestic manufacturing firms.

Chapter 8 provides the key findings and implications which can be divided into three categories. The first covers policymaking as well as domestic and foreign investors; the second covers the implications for economic theory and knowledge; and the third discusses the implications regarding the development
of a strategic framework business models for realizing productivity spillovers from MNCs to domestic firms. This will be followed with the limitations of the research and suggestions for further research.

**Limitations of the Research**

Methodology: It was not possible to use probabilistic (random) sampling of key stakeholders as no sampling frame existed from which to draw a sample, and it would not have been possible to construct one. The research aim was to interview or survey those with experience of FDI in Oman and so purposive sampling was used, in particular snowball sampling, whereby participants who met the criteria were invited to identify other possible participants who fitted the criteria. While this sampling strategy was effective in recruiting participation from those people with the best knowledge of FDI in Oman, it has the disadvantage that one cannot necessarily generalise from the sample to the population from which it is drawn and therefore there is some degree of doubt about how representative the research participants are. Amongst foreign investors, the sampling was limited to companies operational in Oman and therefore there is a risk that the views of MNCs that are unhappy with the business climate in Oman (because they have already left) are not captured. Thus, the findings may represent an overly positive view of MNC’s perceptions of the business environment in Oman. In addition, in the absence of anonymity, respondents may have been reluctant to make any critical remarks about the Omani government or associated institutions for fear of damaging their business relationship.

Private sector: Oman’s private sector faces structural weaknesses and there are numerous causes for this. Some of the many reasons include fragmentation of the private sector in small enterprises that prevents effective implementation of projects and the high cost of borrowing, as well as the difficulty of obtaining the necessary funding required to carry out investment projects. The lack of ability of entrepreneurs truly to lead the projects is another major reason. This can potentially negatively affect the research data collection.
Literature: The literature from Oman’s perspective on both FDI and private sector is limited at best, and unavailable in many cases, which affects some historical aspects.

Secondary data: It is absolutely crucial to have accurate, timely and reliable statistics for better analysis. This problem is not just limited to Oman, but the majority of developing countries. For this research, data was only available between 2002 and 2011; however a longer timeline of data is required to have better understanding of trend shifts and the relations of FDI and the private sector.
Chapter 1

FDI and Private Sector: Theoretical Background

Analysis of the political and economic context of Oman helps to explain the success of FDI in enhancing the productivity of the country’s manufacturing firms. Such analysis is critical when examining why and how firms make their decision to investment in particular industry, how sustainable is the investment, and the extent of their spillover effects. This requires extensive examination of the political economy of natural resources such as oil and gas, the dynamics of rentier state economy, state-business relations, the efficiency of public institutions and their role in the development process, and the effect of rent on development. Critical analysis of these factors are conducted in this section to determine their effects on the growth of FDI and productivity spillovers in the Omani manufacturing sector.

This section provides its analysis of the political economy of Oman and its impact on economic reforms through a detailed examination of the rentier state theory. It begins by looking at how rentier state theory explains the role of institutions and state-business-society relationships in the development of Oman. This is followed by an examination of the interplay between foreign direct investment and local private sector forms, and how such interaction results in spillover effects from foreign to domestic firms. The methods of transmission of spillovers effects are explained through an analysis of the mechanisms through which spillover can occur, including business linkages, labour mobility and demonstration effects, amongst others. Pre-conditional factors for successful spillover to meet the objectives of all stakeholders involved are also examined.

1.1 Rentier State Theory:

A growing volume of literature has dealt with Rentier State Theory (RST), with it consisting of different waves of contributions over time, as illustrated in Figure 1.1. The first wave consists of classical RST as introduced by Hossein Mahdavy in 1970 and expanded upon by Hazem Beblawi and Giacomo Luciani.

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in 1987. The second wave of research literature RST and applies it to the 1990s and 2000s, accounting for country-specific historical developments, international relations, and the influence of major external powers to form a specialized version of RST.\textsuperscript{43} It addresses the issue of state autonomy, politics, and variance between countries to propose a “conditional” form of RST. The third wave of research literature is based on the concept of “late rentierism” and describes seven features of “late rentier” states. After analysing the contributions of these three waves, Oman will be discussed as a case of a rentier political economy.

1.1.1 Classical Rentier State Theory

Mahdavy (1963) introduced the concept of the Rentier State in his analysis of economic development in Iran during the 1960s.\textsuperscript{44} He defined rentier states as, “those countries that receive on a regular basis substantial amount of external rent,” which are, “rentals paid by foreign individuals, concerns or governments to individuals, concerns or governments of a given country.” He considers oil revenues external rents, rather than royalty payments, because the local economy input factors are so minimal that, “one can consider the oil revenues almost as a free gift of nature or as a grant from foreign sources.” According to Mahdavy, rentier states resemble other underdeveloped countries in several ways, including a similar “socio-political structure,” an imbalance in the “input- output matrix,” overvalued currency, inflated wages (in non-oil industries), and the unequal relationship between expenditure and growth. However they differ from other underdeveloped economies in that the aforementioned factors can be causes for instability with the passage of time. In non-rentier states, these factors may lead to a sense of urgency or even political unrest aimed at changing the status quo, whereas in rentier states this sense of urgency is absent because the population actually benefits from the status quo through low taxation and government subsidies.

\textsuperscript{43} Crystal, J. (1995), Oil and Politics in the Gulf: Rulers and Merchants in Kuwait and Qatar. Cambridge University Press.

After defining the character of rentier states, Mahdavy asked why, despite these vast financial resources and the fact that the lack of capital is not a problem\(^{45}\), rentier states have not been among the world’s fastest growing economies? He answers this question firstly in that the “socio-political structure” remains so underdeveloped that the external rents cannot be used for economic development with efficiency and efficacy. Secondly, rentier states encourage consumption behavior that prevents the growth of domestic productive capability. Government expenditure may increase demand for certain goods and services based on the nature of that expenditure but this does not necessarily translate into macroeconomic growth. Additionally, imported goods are also more attractive for reasons related to both quality and prestige. As a result, there is not a one-for-one relationship between expenditure and growth.\(^{46}\)

Mahdavy argues these barriers to economic development can be overcome if rentier states use external rents to subsidize industries that have positive employment effects, rebalance the input-output matrix, and capitalize in well-planned industrial complexes – essentially a three-part economic developments plan for rentier states. Mahdavy optimistically states that technological and labor force development can be incorporated into the above-mentioned plans.

Beblawi (1987) and Luciani (1987) expand Mahdavy’s notion of rentierism by emphasizing the economic role of Arab state formation in the post-colonial era.\(^ {47}\) Luciani makes a distinction between allocation states and production states, arguing that the origin of state revenue, whether domestic or foreign, largely determines state behaviour. Luciani defines allocation states as all those states whose revenue derives predominately (more than 40 percent) from oil or other foreign sources and whose expenditure is a substantial share of GDP.\(^ {48}\) By contrast, production states are those states that depend on the domestic

\(^{45}\) typically a primary constraint in other underdeveloped countries, is not a factor in the economic development of Rentier states

\(^{46}\) Mahdavy refers to an “imbalance in the input-output matrix.” meaning that because Rentier states often undervalue their currency, imports become more affordable than they would be at regular currency exchange rates.


economy for state income, and can grow and perform an allocation function only to the extent that the domestic economy provides the necessary income.

Beblawi and Luciani also point out several political characteristics associated with these rentier models in oil states. For example, where the government is the largest and ultimate employer, the bureaucracy is frequently bloated and inefficient. Moreover, local laws often make it impossible for foreign companies to operate independently. This leads to a situation where citizenship becomes a financial asset. For example, laws prevent foreign enterprises from doing business without a local partner, so that foreign enterprises must engage a local sponsor who allows the company to trade in his or her name in return for a proportion of the profits which is, in effect, another type of rent.

1.1.2 Specialized and Conditional Rentier State Theory

Crystal (1995), Chaudhry (1997), and Hertog (2010) represent the second wave of RST, or “Specialized RST.” They argue for a context-specific approach for explaining rentierism. Much of the literature in this wave of RST critiques what these authors perceive to be an overemphasis on the economy in classical Rentier state theory. Scholars should take into account more than the amount of external rent and its share of government revenue when discussing the political economies of oil-exporting Arab Gulf. Thus, specialized RST argues that political considerations compared to economic considerations are equally, if not more important to understanding rentier state behavior.

Specialized RST is composed of three main themes. These include the importance of historical dynamics, the impact of international relations, and the role of major external powers on the internal dynamics of Rentier states. This theory states that what separates rentier states from non-rentier states in terms of the state-society relationship is that the rentier state is more vulnerable to drastic changes in the amount of external rent it collects, and any change in the social contract between the ruler and the ruled. A more in-depth example of Specialized RST is Schwarz’s (2008) discussion about the political economy of

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50 Hertog (2010)
Arab state formation in which he puts forward two primary arguments. Firstly, he argues that the conventional wisdom surrounding state-formation is heavily anchored in the European experience and is thus irrelevant to the Arab Middle East. The process of state-formation in the Arab Middle East was not driven by domestic taxation for the purposes of war-making, as it was in Europe, but rather by the utilization of oil resources and revenue for the purposes of gaining legitimacy and imposing authority. The state’s security apparatus was still the first institution to be developed, as in Europe. But unlike Europe, the security apparatus was not for the purpose of external war, but rather for the purpose of imposing internal authority. Schwarz concludes that because of these historical circumstances, the rentier state is strong in terms of security function, weak in terms of representation function, and either strong or weak in the welfare function depending on the amount of revenue it has at its disposal.

While Schwarz correctly points out that the process of state formation was very different in the Arab Middle East than in Europe, his analytical approach has some flaws. The foremost of these is that he links legitimacy to the representation function, whereas any discussion about rentier states should link legitimacy to the welfare function. The social contract in rentier states clearly demonstrates that legitimacy comes not from representation but rather from the rent collection-allocation relationship that exists between the state and society. It is therefore the welfare function that takes on greater importance within a rentier state. Implicit in Schwarz’s analysis is that the strength of states can be measured through the ability to effectively engage in administrative functions. From Schwarz’s perspective this means the ability of states to effectively collect taxes. Yet, it is worth noting that the allocation of revenue is also an administrative function, especially in terms of public expenditure. Therefore, the strength of rentier states should instead be measured by the ability to allocate revenue to the population (i.e. the welfare function) in a way that does not incite political instability.


1.1.3 Late Rentierism theory

Gray (2011) work represents a third wave of RST, in which he discusses “late rentierism.” This covers the changes that have occurred within the political economies of the GCC countries during the 1990s and 2000s. Gray identifies globalization, economic and development imperatives, population growth, and employment pressures as the sources of rentier state maturation. The low oil prices of the late 1980s and 1990s changed the global landscape by creating new financial pressures that did not exist for rentier states during the 1970s and early 1980s when oil prices – and thus rents – were substantially higher. Although, Gray acknowledges that “there is more to Gulf politics than rents,” he believes that RST still has “explanatory primacy” when it comes to describing the political dynamics of the region. The seven features describing the “late rentier” model are shown in figure 1.1.

In sum, RST has evolved substantially since it was first used as a theoretical concept by Hossein Mahdavy to analyze economic development in Iran during the 1960s. Taking the above RST literature into consideration regarding Oman’s government and economy will help to develop the discussion surrounding the fate of FDI in Oman.

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**Figure 1.1 Literature on Rentier State Theory**

<table>
<thead>
<tr>
<th>Wave</th>
<th>Leading Authors</th>
<th>Key arguments</th>
<th>Insights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classical RST</td>
<td>H. Mahdavy (1970)</td>
<td>There is a class of states that demonstrate a pattern in political and economic character, called “rentier states: “those countries that receive on a regular basis substantial amounts of external rent,” “Pure” rentier economy does not exist. The “externality” of rent origin. Only a small portion of the total population is engaged in the generation of rent whereas, “the rest of the society is only engaged in the distribution and utilization of this wealth.” The government is the primary recipient of external rents.</td>
<td>The “socio-political structure” remains underdeveloped, “imbalance in the input-output matrix.” An environment conducive to corruption (no clear conflict of interests between holding public office and running private business at the same time) The government is the largest and ultimate employer; Bureaucracy is frequently bloated and inefficient. Local laws often make it impossible for foreign companies to operate independently. Citizenship becomes a financial asset.</td>
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<tr>
<td></td>
<td>H. Beblawi (1990)</td>
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</tr>
<tr>
<td></td>
<td>G. Luciani (1987)</td>
<td>Allocation versus production states, the role of the economy in determining state behavior.</td>
<td></td>
</tr>
<tr>
<td>Specialized and Conditional RST</td>
<td>Crystal (1990), Chaudhry (1997), Hertog (2010), Schwarz’s (2008)</td>
<td>Rentier states do not enjoy autonomy from society, the relationship relies heavily on the interconnectedness of rent collection, allocation, and utilization, the rentier state has legitimacy, not autonomy.</td>
<td>The rentier state is strong in the security function, weak in the representation function, and either strong or weak in the welfare function depending on the amount of revenue it has at its disposal.</td>
</tr>
<tr>
<td>Late Rentierism theory</td>
<td>M. Gray (2011)</td>
<td>The “late rentier” state is responsive but undemocratic. Opening up to globalization, but with some protectionism remaining. State has an active economic and development policy. The state is an energy-driven, not energy-centric economy. State has an “entrepreneurial state capitalist” structure; state is long-term in its thinking. State maintains an active and innovative foreign policy.</td>
<td>Globalization, economic and development imperatives, population growth, and employment pressures as the sources of rentier state maturation.</td>
</tr>
</tbody>
</table>

Source: Compiled by author
1.2 Institutions and Governance

The goal here is to explain what the literature on institutions and governance says about economic development in general, and about FDI in particular, and how this applies to Oman. There is now a strong consensus that good governance, broadly construed, is a fundamental cause of sustained growth and development. Well-governed countries are more successful in creating investment, growth, and employment. As a result, governance has moved to centre stage in the development discourse.  

Development miracles such as those of South Korea and Singapore are now routinely attributed to effective governance while persistent development failures are often traced to incompetent and ineffective states. Thus, the quest for good governance has become a key theme of most long-term development strategies and policies as states integrate governance reforms into their strategic development frameworks.

Governance is a broad multidimensional concept that lacks operational precision. A variety of definitions, differing in scope and rationale have been advanced, ranging from purely technocratic ones that focus on sound development management to those that take a more expansive view encompassing the nature of political regimes, the soundness of economic management and the legal and judicial framework. According to the World Bank, governance refers to the traditions and institutions by which authority in a country is exercised. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to effectively formulate and implement sound policies, and (3) the respect of citizens and the state for the institutions that govern economic and social

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54 Rachel M. Gisselquist, Good Governance as a Concept, and Why This Matters for Development Policy, UNU World Institute for Development Economics Research, Working Paper No. 2012/30, Finland

55 Heritier, P. & Silvestri P. (Eds.), Good government, Governance, Human complexity. Luigi Einaudi's legacy and contemporary societies, Leo Olschki, Firenze, 2012

56 Rachel M. Gisselquist, Good Governance as a Concept, and Why This Matters for Development Policy, UNU World Institute for Development Economics Research, Working Paper No. 2012/30, Finland
interactions among them.  

Similarly, the United Nations Development Programme (UNDP), defines governance as “the exercise of economic, political and administrative authority to manage a country’s affairs at all levels. It comprises the mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.”  

There is a growing literature on the economics of institutions and the role of political economy in understanding institutional performance in developing countries. This includes literature on a variety of topics, including corruption and rent-seeking, the role of property rights and their stability, the role of the state and of different strategies of pursuing economic transitions. Shirley (2005) points out that the literature has lately focused on understanding how institutions change and how they cause economic growth. Successful changes are defined by theorists as those which foster sustained growth and social progress in countries or specific industries within economies. They claim that economic development only happens if two conditions are met. Firstly, institutions must support exchange by lowering transaction costs and encouraging trust. Secondly, institutions must influence the state to protect private property and persons, rather than expropriate and subjugate them. 

This literature helps clarify how institutional problems lead to bad economic development performance. For example, weak property rights enforcement, worse macroeconomic policies, and budget deficit and high inflation will create a business environment which is not attractive for FDI. This of course rules out the benefit of spillovers from FDI. This means that crafting the proper institutions is necessary to address the lack of FDI and its spillover.

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57 Rachel M. Gisselquist, Good Governance as a Concept, and Why This Matters for Development Policy, UNU World Institute for Development Economics Research, Working Paper No. 2012/30, Finland

58 United Nations Development Programme

59 Can explain why countries with better institutions prosper, while those with bad institutions stagnate or decline.

60 Acemoglu and Robinson (2012)

61 Shirley, 2005

62 Fahim al Marhubi, Business today, published: 2/12/2014

1.3 State, Business and Society relations:

State, business and society relations (SBSRs) describes the variety of different interests and actors in a given territory. For example, areas of concern for the private sector are labour, investment regulations, demand, and low taxes. State concerns are for revenue, building absorptive capacity and infrastructure. Society is concerned with a clean environment and improving standards of living and job creation. Achieving a balance among these different interests is a real challenge and it requires a clear political agenda, transparency, and communication.64

Effective SBSRs are linked to the literature on good governance, characterised by four aspects: the rule of law, predictability, transparency and accountability. According to the literature on SBSR, there are two pre-conditions for economic growth. Firstly, the creation of a positive environment for private investment, in which capitalists have confidence that their activities will be supported and not frustrated by the state. Secondly, the state has the capability (and willingness) to restrain the negative effects of collusion between individual business people and agents of the state. These are the institutional conditions for creating the maintenance of benign collaboration between the state and business.66 It is not just governance failure but the cultural factors and

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65 This refers to reduce the cost of political uncertainty and assures businesses that the government will not manipulate information for personal gain. This depends on numerous factors including the type of policy, information flows, the reputations of the officials involved, and government backing also, drawbacks such as tying the hands of policymakers, limiting their flexibility

development partners' attitude about the country which mostly determines FDI inflow.\textsuperscript{67}

The SBSR literature highlights three factors that can cause government policies to be less effective. Firstly, the extreme self-interest of the bureaucracy can lead to policies that have an adverse effect on social welfare. Secondly, rent seeking behaviour of certain groups which try to gain privileges from the government can come at the expense of other groups. Thirdly, the opportunism of politicians, which may often take place in the period before elections, can also come at the expense of long term objectives.\textsuperscript{68}

The SBSR literature provides insight into the political dimensions that pertain to FDI. SBSRs can speed up investment climate reform, as it is possible to correlate SBSR variables with the various Investment Climate Indicators contained in the World Bank’s ‘Doing Business’ Reports over time and across countries.\textsuperscript{69} These indicators describe the difficulties faced by normal business operations, such as the number of procedures it takes to obtain licences, or to export goods and services. Although some procedures are likely to be necessary, others could be streamlined.

Moreover, effective state-business and society relations may help to reduce policy uncertainty and therefore increase FDI. This is because firms operate in an uncertain environment and frequently face risk and resource shortages. They undertake decisions concerning technology, inputs, and production facilities based on anticipated market conditions and profitability. Uncertainty can have significant negative effects on investment, when investment involves large sunk and irreversible costs, and there is the option to delay the decision to make the investment until further information becomes available.\textsuperscript{70} Thus policy uncertainty is an important source of uncertainty for

\textsuperscript{68} Jensen, N. M. (2006), Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment, Princeton University Press
investors, making them less likely to invest. Businesses that have a better relationship with the government may be better able to anticipate policy decisions. However, when these relationships become too close, collusive behaviour may result in the capture of policy to the benefit of few rather than all firms.

To have a better understanding of the state-business relations in a region, we will dwell a little on how these three pillars are linked with each other, explaining the current outcome and how this relation can be improved by turning to private sector-led growth.\(^7\) The Growth Commission report suggested a number of enhancements in government activity that can yield fruitful results.\(^2\) This include, facilitating knowledge transfer and access to markets, supporting macroeconomic stability, providing public investment in infrastructure and in health and education, and providing strong leadership and capable administration.

Finally, the private sector has an equally important role to play in the greater capital formation in a society. This includes manufacturing and processing goods, employment and in economic diversification into several segments, and additional services that help the private sector expanding. By better organizing and expanding the private sector to fulfill its role, the nation at large can benefit.

### 1.4 Definitions and Concepts of FDI

The most widely accepted definition of FDI was developed by the International Monetary Fund (IMF) as a component of the Balance of Payments, “International investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident from another economy.”\(^3\) This definition was subsequently revised by the OECD in its Benchmark Definition (OECD 1996). FDI represents investment where the direct

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\(^7\) Steffen Hertog (2012), Diversified But Marginal: The GCC Private Sector as an Economic and Political Force, the Center for Gulf Studies at the American University of Kuwait.


\(^3\) International Monetary Fund (1993), Balance of payments manual fifth edition (BPM5).
investor wishes to exert a lasting interest in and exert a degree of influence over the management of the company in which the investment is made. FDI flow comprise three different components:

1) Equity capital: The foreign direct investor’s net purchase of the shares and loans of an enterprise in a country other than its own.

2) Reinvested Earnings: Retained earnings are the accumulated earnings of the enterprise not distributed to shareholders and available for reinvestment in the operations of the company. The share of the foreign direct investor in the stock of retained earnings corresponds to the foreign direct investor’s percentage ownership in share capital (i.e. % ownership in share capital x stock of retained earnings).

3) Intra-company loans: Short or long-term loans from parent firms to affiliate enterprises or vice versa. Also included are trade credits, bonds and money market instruments, financial leases and financial derivatives.

According to the World Investment Report of 2012, stagnant global flows in 2011 were accompanied by diverging trends in FDI inflow components, improved economic performance in many parts of the world, and increased foreign affiliate profits, which in turn increased reinvested earnings to nearly double their 2009’s level. This reflects a general global profit increase. However, not all reinvested earnings are actually reinvested in productive capacity. These may be put aside as savings for better future investment opportunities, or to finance other activities, including those that are speculative. In 2011 about 40% of FDI income was retained as reinvested earnings in host countries. One of the three components of FDI flows remained at its lowest level in recent years, particularly in developed countries. At the same time, difficulties with raising funds from third parties, such as commercial banks, obliged foreign affiliates to rely on intercompany loans from their parents to maintain their current operations. The increase in reinvested earnings compensated for the decline in equity capital flows, which were slightly down despite an up-turn in cross-border M&As. The continuing depressed level of equity investments was still the key factor in maintaining the need for FDI. In addition, FDI and other forms of investment do not necessarily replace each other. In fact they complement each other as some of the investment could also come from the domestic market and foreign investors could provide the credit line for technology.
There are two forms of FDI. The first is a greenfield investment which involves establishing a wholly owned new operation in a foreign country. This form is mostly used in developing nations and the main reason is lack of suitable target firms. It requires a longer time horizon for return on investment. It occurs through hiring or buying local resources, constructing or buying buildings or building own labour force. The second type of FDI is an acquisition or merger with an existing domestic firm in the host country, through buying an existing company. It is easy to execute, gains brand identification and goodwill, can help to acquire knowledge, local financing may be possible, and it eliminates a competitor. According to the UNCTAD the greater part of MNCs activities are in the form of acquisitions and mergers rather than greenfield investment. Firms prefer to acquire existing assets because mergers and acquisitions are quicker to execute than greenfield investments; it is easier and perhaps less risky for a firm to acquire desired assets than build them from the ground up; and firms believe they can increase the efficiency of an acquired unit by transferring capital, technology, or management skills.\(^74\)

A foreign direct investor may be an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises. Foreign direct investors own ten per cent or more of the ordinary shares or voting power of an enterprise in another economy. According to the World Investment Directory, MNCs or TNCs or FDIEs are the most important carriers of FDI.\(^75\) A foreign direct investment enterprise may be the head of an enterprise group, a subsidiary, a branch, or an associated enterprise. The term "affiliate" is used to refer to all of these types of enterprises.\(^76\)


\(^75\) The World Investment Directory provides detailed information about foreign direct investment in a country, comprising statistics on flows, stocks and MNC operations, disaggregated by components, industry and investor/recipient country.

\(^76\) Johannes Stephan (2013), The Technological Role of Inward Foreign Direct Investment in Central East Europe, Palgrave Macmillan.
1.5 Theoretical Perceptions on FDI effects on Domestic Companies

The impact of FDI on the domestic economy has been a subject matter of lively debate in many economic groups over recent years. They all argue that FDI has an influence on the local private sector, which depends on host country conditions and the type of FDI inflows. We can distinguish between three main views.

The existing literature on this subject is of three types, case studies, industry-level studies and firm-level data panel. There are strengths and weaknesses in each type, as can be seen from table 1.1.

Table 1.1: Forms of Literature on Spillover Effects from FDI to Domestic Firms

<table>
<thead>
<tr>
<th>Form of studies</th>
<th>Strength</th>
<th>Weakness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on Case Studies</td>
<td>Very informative and includes a wealth of valuable information</td>
<td>Concern with particular projects or specific countries, not offering quantitative information and cannot be generalized</td>
</tr>
<tr>
<td>Theodore H. Moran, 2001</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Based on Industry-level data</td>
<td>Most of them show a positive correlation between FDI presence and average value added per worker in the sector</td>
<td>Most of them rely on cross sectional data. Causes of the correlation are not clear</td>
</tr>
<tr>
<td>Jonathan E. Haskel et al. (2002)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

77 The relationship between FDI and domestic investment is likely to be complimentary when investment is in an undeveloped sector of the economy. But the FDI is more likely to substitute for domestic investment when it takes place in sectors where there are plenty of domestic firms or when domestic firms already have access to technology that the TNCs bring into the country.

<table>
<thead>
<tr>
<th><strong>Based on firm level panel data</strong></th>
<th><strong>Try to examines whether productivity of domestic firms is correlated with extent of foreign presence in the sector</strong></th>
<th><strong>Difficult to find and approve a significant effect</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Aitken and Harrison (1999) on Venezuela</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Compiled by author

### 1.5.1 Perceptions on the positive effects of FDI and domestic firms

As illustrated in Table 1.2 numerous studies support the view that the effects of FDI on domestic firms are largely positive. These include the Eclectic Paradigm (OLI)\(^79\) theory by Dunning (1993), Cave (1982), Peter et al, (2005), Fry, (1992); Borensztein et al., (1998); Bosworth and Collins, (1999); De Mello, (1999); Agosin and Mayer, (2000); Lipsey, (2000), Moran, (1998). All of these studies argue that FDI has a positive impact on the host economy in general and domestic companies in particular, as it accelerates economic growth, generates income, and contributes to the economic development process beyond available domestic resources. For example, where there is technology that leads to enhanced efficiency, the host economy labour will need to develop expertise which they can use to their own advantage in the labour market and contribute to productivity.\(^80\) Also, FDI brings new management skills - which lead to better control on time and quality, and marketing techniques which lead to enhanced exports. So the MNC could help raise the level, content and value of what the country is already exporting as well as discover new markets and products. Another advantage is capital. FDI leads to an expansion of domestic capital formation beyond what could be financed with domestic savings,\(^81\) through financial resources brought by FDI inflows and by encouraging domestic capital, as when an MNC enters a sector where many domestic firms already exist, local firms will increase investment in order to face competition.\(^82\) However, if an MNC enters an underdeveloped sector, it will create complementarities with the domestic firms.\(^83\)

\(^79\) Ownership advantage, Localization advantage and Internalization advantage

\(^80\) Chone 2006

\(^81\) Complementing domestic savings

\(^82\) De Mello, 1999

\(^83\) Markusen and Venables, 1999; Driffield and Munday, 2000
MNCs can be used as a benchmark for domestic companies with respect to various parameters, for example, quality control, best practice and managerial skills - which leads to an increased labour productivity. On the other hand, competition between MNCs and domestic firms leads to better efficiency and increased integration in global markets. R&D and innovation rate may be increased and the cost may be decreased, which could help to induce new production processes and products. In fact, MNCs if appropriately managed can improve the efficiency of utilizing infrastructure including roads, ports, telecommunications, etc. which increase the profitability of domestic investment, and create a new demand for local inputs.

Furthermore, MNCs can help in the creation of potential agglomeration economies and improve the business environment, which attracts more investors. MNCs may also reduce unemployment by providing more jobs for the local labour force and the construction of more factories. The indirect benefits of MNCs impact on domestic companies and SMEs occur through the “multiplier” effect.

Studies supporting the view that the effects of FDI on domestic firms are largely positive include Findlay (1978). She postulates that FDI increases the rate of technical progress in the host country through a contagion effect from the more advanced technology, management practices, etc. used by the foreign firms. Also, Wang (1990) assumes that the increase in knowledge applied to production is determined as a function of foreign direct investment (FDI). Borensztein, De Gregorio and Lee (1998), uses data from 69 developing countries over the last two decades to argue that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than to domestic investment. However, the higher productivity of FDI holds only when

84 Blomstrom, 1989
85 Cardoso and Dornbusch, 1989
86 Cardoso and Dornbusch, 1989
87 These are jobs, which if not for the foreign investor, would not exist.
88 This occurs when employees of FDI projects spend their wages on local goods and services and FDI projects directly purchase goods and services from domestic enterprises that will experience an increase in demand for the products and hence will produce and supply more. This process also occurs through increase spending from company employees who will higher incomes due to the wages and salaries they earn. Their increase in disposable income leads to increases in spending and hence economic activity. These second and third rounds of spending and demand impact largely on local SMEs.
the host country has a minimum threshold stock of human capital.\textsuperscript{89} Wild et al (2008) showed that Singapore has been successful in accessing and developing their own technological expertise in harbor industry.

Others argue that investors not only bring technology to the host country but also upgrade existing technology, or better, they invent new ones. Richard E. Caves (1974) focused on Australia, arguing that due to the large technological gap between foreign and domestic firms, the scope for spillovers has been smaller. Caves (1974) made use of industrial cross-section data for the years 1962 to 1966, for 23 manufacturing industries to examine Australian technology spillover effects. He found labour productivity of Australian manufacturing industry was positive in relation to the inner industry. Blomstrom and Persson (1983) analysed Mexican industrial cross-section data in the year 1970, taking labour productivity as a measure of technology level, and labour efficiency as impacting characteristic variables, and he found positive technology spillovers effects. In addition, Kokko (1994) analysed Mexican industrial cross-section data for the year 1970, and discovered only when multinational companies adopted rather simple technology there was a narrow technology gap between multinational companies and local companies. Thus, technology spillover effects would arise.

Table 1.2: FDI and Private Sector Interaction-Positive

<table>
<thead>
<tr>
<th>Reference</th>
<th>Year</th>
<th>Country</th>
<th>Period</th>
<th>Data</th>
<th>Spillover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caves</td>
<td>1974</td>
<td>Australia</td>
<td>1966</td>
<td>CS</td>
<td>Employment</td>
</tr>
<tr>
<td>Sjoholm</td>
<td>1997</td>
<td>Indonesia</td>
<td>198,89</td>
<td>CS</td>
<td>Output</td>
</tr>
<tr>
<td>Blomstrom and Persson</td>
<td>1983</td>
<td>Mexico</td>
<td>1970</td>
<td>CS</td>
<td>Employment</td>
</tr>
<tr>
<td>Blomstrom and Wolff</td>
<td>1994</td>
<td>Mexico</td>
<td>1970</td>
<td>CS</td>
<td>Employment</td>
</tr>
<tr>
<td>Kokko</td>
<td>1994</td>
<td>Mexico</td>
<td>1970</td>
<td>CS</td>
<td>Employment</td>
</tr>
<tr>
<td>Blomstrom and Wolff</td>
<td>1989</td>
<td>Mexico</td>
<td>1965,84</td>
<td>CS</td>
<td>Share in employment</td>
</tr>
<tr>
<td>Blomstrom and Sjoholm</td>
<td>1999</td>
<td>Indonesia</td>
<td>1997</td>
<td>cs</td>
<td>Output</td>
</tr>
<tr>
<td>Blomstrom and Sjoholm</td>
<td>1999</td>
<td>Indonesia</td>
<td>1991</td>
<td>CS</td>
<td>Assets</td>
</tr>
<tr>
<td>Chuang and Lin</td>
<td>1999</td>
<td>Taiwan</td>
<td>1991</td>
<td>CS</td>
<td>Assets</td>
</tr>
<tr>
<td>Sjoholm</td>
<td>1999a</td>
<td>Indonesia</td>
<td>1980-1991</td>
<td>CS</td>
<td>Output</td>
</tr>
<tr>
<td>Sjoholm</td>
<td>1999b</td>
<td>Indonesia</td>
<td>1980-1991</td>
<td>CS</td>
<td>Output</td>
</tr>
<tr>
<td>Yudeava et al</td>
<td>2000</td>
<td>Russia</td>
<td>1993-97</td>
<td>Panel</td>
<td>Share in output</td>
</tr>
<tr>
<td>Aslanoglu</td>
<td>2000</td>
<td>Turky</td>
<td>1993</td>
<td>CS</td>
<td>Value added</td>
</tr>
<tr>
<td>Driffield</td>
<td>2001</td>
<td>UK</td>
<td>1989-1992</td>
<td>CS</td>
<td>Output</td>
</tr>
<tr>
<td>Sgard</td>
<td>2001</td>
<td>Hungary</td>
<td>1992-99</td>
<td>Panel</td>
<td>Equity</td>
</tr>
<tr>
<td>castillani and zanfei</td>
<td>2001</td>
<td>France, Italy, and Spain</td>
<td>1993-97</td>
<td>Panel</td>
<td>Share in employment</td>
</tr>
<tr>
<td>kokko, Tasini and Zejan</td>
<td>2001</td>
<td>Uruguay</td>
<td>1988</td>
<td>CS</td>
<td>Output</td>
</tr>
<tr>
<td>Liu et al.</td>
<td>2001</td>
<td>China</td>
<td>1996/1997</td>
<td>CS</td>
<td>Assets</td>
</tr>
<tr>
<td>Li et al.</td>
<td>2001</td>
<td>China</td>
<td>1995</td>
<td>CS</td>
<td>Assets/Employment</td>
</tr>
<tr>
<td>Liu</td>
<td>2002</td>
<td>China</td>
<td>1993-1998</td>
<td>Panel</td>
<td>Equity</td>
</tr>
<tr>
<td>schoors and v.d tol</td>
<td>2002</td>
<td>Hungary</td>
<td>1997-98</td>
<td>cs</td>
<td>Sales</td>
</tr>
<tr>
<td>Barrios and Strobl</td>
<td>2002</td>
<td>Spanish</td>
<td>1990-98</td>
<td>Panel</td>
<td>Share in sales</td>
</tr>
<tr>
<td>dimelis and louri</td>
<td>2002</td>
<td>Greece</td>
<td>1997</td>
<td>cs</td>
<td>Share in employment</td>
</tr>
<tr>
<td>Buckley et al</td>
<td>2002</td>
<td>China</td>
<td>1995</td>
<td>CS</td>
<td>Assets/Employment</td>
</tr>
<tr>
<td>Grima and Gorg</td>
<td>2003</td>
<td>UK</td>
<td>1980-92</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Bouoiyour</td>
<td>2003</td>
<td>Morocco</td>
<td>1987-96</td>
<td>Panel</td>
<td>Share equity</td>
</tr>
<tr>
<td>Yudeava et al</td>
<td>2003</td>
<td>Russia</td>
<td>1993-97</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Buckley et al</td>
<td>2003</td>
<td>China</td>
<td>1995</td>
<td>cs</td>
<td>Share in employment</td>
</tr>
<tr>
<td>Ratto and stokke</td>
<td>2003</td>
<td>Thailand</td>
<td>1975-96</td>
<td>Panel</td>
<td>Investment, trade</td>
</tr>
<tr>
<td>Keller and Yeapel</td>
<td>2003</td>
<td>U.S.</td>
<td>1987-96</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Lutz and Talavera</td>
<td>2004</td>
<td>Ukraine</td>
<td>1998-99</td>
<td>panel</td>
<td>FDI in industry-region</td>
</tr>
<tr>
<td>sinani and Meyer</td>
<td>2004</td>
<td>Estonia</td>
<td>1994-99</td>
<td>Panel</td>
<td>equity, sales, employment</td>
</tr>
<tr>
<td>Karpaty and Lunderberg</td>
<td>2004</td>
<td>Sweden</td>
<td>90-200</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Takii</td>
<td>2005</td>
<td>Indonesia</td>
<td>1990-95</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Girma</td>
<td>2005</td>
<td>UK</td>
<td>1989-99</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Dimelis</td>
<td>2005</td>
<td>Greece</td>
<td>1992-97</td>
<td>CS</td>
<td>Equity</td>
</tr>
<tr>
<td>Ruane and Ugur</td>
<td>2005</td>
<td>Ireland</td>
<td>1991-98</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Wei and Liu</td>
<td>2006</td>
<td>China</td>
<td>98-2000</td>
<td>Panel</td>
<td>Capital</td>
</tr>
<tr>
<td>Buckley et al</td>
<td>2007a</td>
<td>China</td>
<td>2001</td>
<td>cs</td>
<td>share in capital</td>
</tr>
<tr>
<td>Driffield and love</td>
<td>2007</td>
<td>UK</td>
<td>1987-97</td>
<td>Panel</td>
<td>Capital</td>
</tr>
<tr>
<td>Wang Yu</td>
<td>2007</td>
<td>China</td>
<td>2001</td>
<td>CS</td>
<td>Employment, capital</td>
</tr>
<tr>
<td>Tian</td>
<td>2007</td>
<td>China</td>
<td>1996-99</td>
<td>Panel</td>
<td>Sales, Employment</td>
</tr>
<tr>
<td>Xu and Sheng</td>
<td>2011</td>
<td>China</td>
<td>2000-2003</td>
<td>firm level</td>
<td>Output</td>
</tr>
<tr>
<td>Managi and Bwlya</td>
<td>2010</td>
<td>Kenya, Tanzania and Zimbabwe</td>
<td>1993-1995</td>
<td>firm level</td>
<td>Output</td>
</tr>
<tr>
<td>Jordaan</td>
<td>2010</td>
<td>Mexico</td>
<td>1994</td>
<td>industry level</td>
<td>Labour productivity</td>
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<tr>
<td>Xu and Sheng</td>
<td>2011</td>
<td>China</td>
<td>2000-2003</td>
<td>firm level</td>
<td>Output</td>
</tr>
</tbody>
</table>

Source: Compiled by author

1.5.2 Perceptions on the negative effects of FDI and domestic firms

As can be illustrated in table 1.3, some studies have claimed that FDI has negative effects on domestic firms. These include: Veron (1971) and Jenkins...
(1987), De Backer and Sleuwaegen (2003), Aitken and Harrison (1999). They all argue that FDI could have a negative impact on the host economy in terms of intense competition and dominating the market and the resulting crowding out\textsuperscript{90} of small and medium domestic enterprises (SME).\textsuperscript{91} Also, it increases the income gap in a society through provision of high wages to its employees in contrast to lower wages paid by local firms,\textsuperscript{92} as well as increasing unemployment rate as FDI increases wages and the price of locally supplied inputs. This leads to reduced employment and displacement of domestic firms.

Other studies (Fry, 1992; Agosin and Mayer, 2000) argued that FDI reduces domestic investment, because MNCs are technologically more advanced and are likely to be able to exploit possible opportunities more rapidly and effectively that primarily were open to domestic investors.\textsuperscript{93} Disadvantages include lower domestic savings and investment, including via profit repatriation; crowd-out of domestic companies; increased demand for foreign exchange; supporting local oligopolies and being monopolistic; twisting local politics and spoiling regulation; and creating instability through increased financial volatility. This keeps local domestic companies underdeveloped and dependent on MNCs for investment, technology and jobs. This affects the profitability of domestic investment, as MNCs draw demand from the less efficient domestic firms, thus forcing them to cut production, and therefore costs go up.\textsuperscript{94} Furthermore, MNCs’ activities may increase imports and worsen the terms of trade. This may lead to a loss of the potential domestic productivity comparative advantage, increased prices of capital goods as well as exploiting the host economy’s national resources to the advantage of the home country.

\textsuperscript{90} This happens when there is a large technological gap and the labor force in the host country is not sufficiently qualified (Kokko, 1994; Borensztein et al., 1998). Also because of differences in the access to credit between foreign and domestic firms.


\textsuperscript{92} De Backer and Sleuwaegen, 2003; P. 68

\textsuperscript{93} Aitken and Harrison, 1999

\textsuperscript{94} Aitken and Harrison 1999
Table 1.3: FDI and Private Sector Interaction - Negative

<table>
<thead>
<tr>
<th>Reference</th>
<th>Year</th>
<th>Country</th>
<th>Period</th>
<th>Data</th>
<th>Spillover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cantwell</td>
<td>1986</td>
<td>European countries</td>
<td>1955,75</td>
<td>CS</td>
<td>change in the market share</td>
</tr>
<tr>
<td>Haddad and Harrison</td>
<td>1993</td>
<td>Morocco</td>
<td>1985-1989</td>
<td>Panel</td>
<td>Assets</td>
</tr>
<tr>
<td>Kokko et al.</td>
<td>1996</td>
<td>Uruguay</td>
<td>1970</td>
<td>CS</td>
<td>Output</td>
</tr>
<tr>
<td>Aitken and Harrison</td>
<td>1999</td>
<td>Venesuela</td>
<td>1976-1989</td>
<td>Panel</td>
<td>Combined</td>
</tr>
<tr>
<td>Zukowska - Gagelmann</td>
<td>2000</td>
<td>Poland</td>
<td>1993-97</td>
<td>Panel</td>
<td>Output</td>
</tr>
<tr>
<td>Kathuria</td>
<td>2000</td>
<td>India</td>
<td>1976-1989</td>
<td>Panel</td>
<td>Output</td>
</tr>
<tr>
<td>Konings</td>
<td>2001</td>
<td>Romania</td>
<td>2004</td>
<td>Panel</td>
<td>Productivity</td>
</tr>
<tr>
<td>Barrios and strobl</td>
<td>2002</td>
<td>Spain</td>
<td>1990-98</td>
<td>Panel</td>
<td>Sales</td>
</tr>
<tr>
<td>castellani and zanfei</td>
<td>2002</td>
<td>Italy</td>
<td>1992-97</td>
<td>panel</td>
<td>share in employment</td>
</tr>
<tr>
<td>Khawar</td>
<td>2003</td>
<td>Mexico</td>
<td>1990</td>
<td>CS</td>
<td>Total assets</td>
</tr>
<tr>
<td>narula and marin</td>
<td>2003</td>
<td>argentina</td>
<td>1992,96</td>
<td>CS</td>
<td>change in percent foreign employment</td>
</tr>
<tr>
<td>De Backer &amp; Sleuwaegen</td>
<td>2003</td>
<td>Belgium</td>
<td>2003</td>
<td>Panel</td>
<td>Crowd out LDCs</td>
</tr>
<tr>
<td>lenger and taymaz</td>
<td>2004</td>
<td>Turkey</td>
<td>1983-00</td>
<td>panel</td>
<td>share in employment</td>
</tr>
<tr>
<td>Driffield</td>
<td>2004</td>
<td>UK</td>
<td>1989-97</td>
<td>Panel</td>
<td>Capital</td>
</tr>
<tr>
<td>Barry et al</td>
<td>2005</td>
<td>Ireland</td>
<td>1990-98</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>hale and long</td>
<td>2006</td>
<td>China</td>
<td>2001</td>
<td>CS</td>
<td>share in employment</td>
</tr>
<tr>
<td>Bwalya</td>
<td>2006</td>
<td>Zambia</td>
<td>1993-95</td>
<td>Panel</td>
<td>Employment</td>
</tr>
<tr>
<td>Flores et al</td>
<td>2007</td>
<td>Portugal</td>
<td>1992-95</td>
<td>Panel</td>
<td>Value added</td>
</tr>
<tr>
<td>Halpern and MURAKOZY</td>
<td>2007</td>
<td>Hungary</td>
<td>1996-2003</td>
<td>Panel</td>
<td>Equity</td>
</tr>
<tr>
<td>Lileeva</td>
<td>2010</td>
<td>Canada</td>
<td>1981-1997</td>
<td>plant</td>
<td>level Employment</td>
</tr>
<tr>
<td>Lileeva</td>
<td>2010</td>
<td>Canada</td>
<td>1981-1997</td>
<td>plant</td>
<td>level Employment</td>
</tr>
</tbody>
</table>

Source: Compiled by author

1.5.3 Perceptions on the effects of FDI on domestic firms under certain conditions

A number of studies provide evidence that the positive effects of MNCs depend on certain preconditions. For example, Lipsey (2002) suggests that the positive impact of FDI will only be felt under certain local conditions such as the stock of human capital, openness of the trade regime and the size of the

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economy. Also, The World Bank’s 2001 edition of global development finance talks about the importance of absorptive capacities in the host economy which include, regulatory quality, role of law, accountability, political stability and control of corruption. Borensztein, De Gregorio and Lee (1998) use data from 69 developing countries over the last two decades to suggest that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. However, the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital.\textsuperscript{96}

Beata Javorcik (2004), argued that positive productivity spillover from FDI to local firms is associated with projects sharing domestic and forging ownership but not with fully owned foreign investment enterprise. Meyer and Sinani 2008, through meta-analysis demonstrate that FDI does generate positive spillovers under certain circumstances.\textsuperscript{97} Cohen argues in his book ‘MNC and FDI’ (2010) that the behaviour and effects of FDI in host economy are complex; they depend on the qualified human capital in the host country. Also, Bhagwati (1978) emphasizes the host country’s openness to trade.\textsuperscript{98} Rajneesh Narula\textsuperscript{99} (2004) argues that FDI could lead to economic development if FDI results in technology transfer, and if domestic firms internalise the spillovers, and if domestic non-firm sector support learning. De Mello (1999) and Xu (2000) stress the size of the technological gap between multinational and domestic firms, which should not exceed a threshold level in order to facilitate spillover effects. Also, the effect of FDI on productivity of domestic firms depends on the sectoral distribution of FDI. The effect of FDI varies among sectors, and it is stronger in the service sector compared to the manufacturing sector. Alfaro et al. (2004), emphasize the need for a certain level of development in the local financial markets.\textsuperscript{100}


\textsuperscript{97}These circumstances are related to local firms’ motivation and capability to react to foreign entry, which are grounded in their human capital and the institutional framework.

\textsuperscript{98}Bhagwati, 1978
\textsuperscript{99}Editor-in-Chief, European Journal of Development Research

\textsuperscript{100} In countries with low levels of development, direct competition between local and foreign investment firms is strong, while opportunities for demonstration effects decline. In developing countries benefit from both moderate technology gap and modest absorptive capacity and direct competition is likely to have a substantial negative effect.
1.6 Productivity Spillover Effects From FDI

Globalization has enhanced the way in which FDI can support the host economy and for this to happen FDI needs to be analysed in a much broader sense,\textsuperscript{101} not just in regard to its rate as a provider of capital and job opportunities, but also as an avenue to benefit the host economy and human development in general.\textsuperscript{102} The key issue has been how to maximize the economic contribution of FDI,\textsuperscript{103} as attracting FDI does not automatically lead to maximising FDI benefits. It needs to linkages with domestic companies, which is not an easy task. Javorcik (2004), in his survey defines spillovers at the firm level as knowledge created by MNCs that is used by DCs for which the host-country firm does not compensate the MNCs.\textsuperscript{104} There are a lot of difficulties associated with capturing spillover effects\textsuperscript{105} and factors that can influence the degree of spillovers in each economy.\textsuperscript{106} Therefore, surveys of literature have concluded that the evidence is mixed in terms of level, direction, and even existence of spillovers from FDI.\textsuperscript{107} The spillovers connected with inward FDI and generated by non-market transactions involving MNCs resources spread to local host country competitors without a contractual relationship.\textsuperscript{108} This may be reflected in improved productivity, or other benefits,\textsuperscript{109} such as the acquisition of

\begin{footnotesize}
\begin{enumerate}
\item Cohen (2007).
\item MNCs have an incentive to prevent any leakage that would enhance the performance of their local competitors.
\item Exploring spillovers is not an easy assignment. Different statistical approaches are not able to provide robust evidence for spillovers. This does not mean that spillovers are non-existent. Empirical evidence suggests that under specific circumstances and for companies with specific characteristics, spillovers occur. These may include; technological and geographical proximity, linkages, access and competition in the market.
\item Blomstro¨m and Kokko (1998); Saggi (2002); Go¨rg and Strobl (2001); Lipsey (2002) Javorcik and Spatareanu (2005), Go¨rg and Greenaway (2004)
\end{enumerate}
\end{footnotesize}
skills, competition and exports as channels through which developing host countries may achieve productivity gains via intra-industry spillovers. However, with all the evidence demonstrated in Table 1.4, to date theorists have not gone so far as to explore fully when precisely these spillovers might be large, small or non-existent.\(^\text{110}\)

**Table 1.4: Literature Review on Spillover Classification**

<table>
<thead>
<tr>
<th>Effect</th>
<th>Direct</th>
<th>Indirect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lipsey, 2002</td>
<td>Increased employment, capital, usage of more advanced equipment and technology</td>
<td>Improve process, and distribution technology, as well as management and marketing skills</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Framework</th>
<th>Supply Considerations</th>
<th>Demand Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits and cost associated</td>
<td>Intellectual Property Protection, Technology available in exchange</td>
<td>Costs of Absorbing, Value of underlying Spillover</td>
</tr>
<tr>
<td>Magnus Blomström, Steven Globerman &amp; Ari Kokko; 1999</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Factors</th>
<th>MNCs</th>
<th>Domestic firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blomstrom and Sjoholm, 1999</td>
<td>Compete successfully with local firms with newer and more advanced technology.</td>
<td>Forced to change their techniques and increase their productivity in order to maintain their market shares and profits after the entry of MNCs.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Programmes</th>
<th>Government-Driven</th>
<th>Private Sector-Driven</th>
</tr>
</thead>
<tbody>
<tr>
<td>UNCTAD, 2006b and Ruffing, 2006</td>
<td>Creating an enabling environment for linkages, strengthen Absorptive Capacity, policies, institutions and concrete</td>
<td>Purely private carried out by MNCs in their own self-interest. Example: Toyota, Volkswagen</td>
</tr>
</tbody>
</table>

\(^{110}\) Caves, E. R. (1999). Spillovers from multinationals in developing countries: The mechanisms at work. In William Davidson Institute conference on ‘the impact of foreign investment on emerging markets’, School of Business Administration, University of Michigan, USA, 18–19 June.
<table>
<thead>
<tr>
<th>Knowledge</th>
<th>Objective knowledge</th>
<th>Experiential knowledge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Penrose (1956)</td>
<td>This knowledge is explicit and examples include market data, legislation and export procedures. This kind of knowledge can be traded in the market.</td>
<td>Experience cannot be transmitted. It produces a subtle change in individuals and it cannot be separated from them.</td>
</tr>
<tr>
<td>Influence</td>
<td>Push</td>
<td>Pull</td>
</tr>
<tr>
<td>Cohen (2007)</td>
<td>Economic conditions outside of host economy such as international interest rate</td>
<td>Economic conditions inside host economy such as absorptive capacity and policies</td>
</tr>
<tr>
<td>Result</td>
<td>Griliches (1979)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Knowledge spillovers</td>
<td>Rent spillovers</td>
</tr>
<tr>
<td></td>
<td>Arise purely from the process of research and development (R&amp;D). Typically from the mobility of workers and exchange of information at conferences and reverse engineering.</td>
<td>Resulting from imperfect price adjustments following quality improvements of goods and services. Associated with exchange of goods and services.</td>
</tr>
<tr>
<td>Mobility</td>
<td>Grunfeld (2002)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Embodied Knowledge</td>
<td>Disembodied knowledge</td>
</tr>
<tr>
<td></td>
<td>These spillovers are preserved in goods and in workers.</td>
<td>Related to intangibles such as services</td>
</tr>
<tr>
<td></td>
<td>Active knowledge spillovers.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This is easily codified knowledge in the form of blueprint knowledge such as patents. It is preserved</td>
<td>Passive knowledge spillovers</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Passive knowledge spillovers</td>
<td>These spillovers are difficult to obtain because only some elements of the knowledge or</td>
</tr>
<tr>
<td>Place</td>
<td>Intra – industry</td>
<td>Inter - industry</td>
</tr>
<tr>
<td>-------</td>
<td>------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>Blomstrom, (1991)</td>
<td>Potential channels are demonstration, competition and labour mobility</td>
<td>Come from the vertical linkages of MNCs with local firms who become their suppliers and customers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Raj Kumer 2003</th>
<th>Crowding in</th>
<th>Crowding out</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development and upgrading of domestic firms to benefit from linkages with MNCs to raise the efficiency of production</td>
<td>Intense competition and dominating the market resulting in crowding out infant domestic industry</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Externalities Forms</th>
<th>Productivity</th>
<th>Market-access</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blomstrom and Kokko (1998)</td>
<td>Local firms improve productivity by copying MNCs, through labour mobility or reverse engineering.</td>
<td>Whenever local firms can have access to international market through export oriented MNCs</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Policy</th>
<th>Pro-Market</th>
<th>Pro-Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emphasis on creating domestic conditions for effective business competition, support for general R&amp;D, infrastructure development and technology can be transferred. Tacit knowledge related to intangibles such as experience, routines and norms is embodied in workers and hence difficult to transfer.</td>
<td>Emphasis on firm and sector-specific policies subsidies, research support, transaction and investment rules</td>
<td></td>
</tr>
</tbody>
</table>
### Productivity Spillover Channels from FDI

This section focuses on the spillover channels between MNCs and local companies, which include technology, management, marketing techniques, capital, best practice and skill, which raises productivity and competition resulting in improved efficiency of the domestic market.

#### 1.7.1 New Technology and know-how leads to enhanced efficiency

Technological spillovers occur when local companies benefit from original knowledge generated by other MNC companies without incurring any research and development costs.\(^{111}\) Technological knowledge is a fundamental factor of long run growth and the focus in all growth theory. The neo-classical growth theory assigned central importance to knowledge in explaining long run growth. However, it considered knowledge as exogenously determined and focused solely on beneficial technology. The technology gap theory of long run economic growth, which is an essentially appreciative theory, emphasized the advantages of technological backwardness and scope for catching up with the technology

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The new growth theory stresses the role of innovative investment, human capital accumulation and externalities as the dominant factors that determine long run economic growth. MNCs are considered to be a major channel for the access to technology and know-how through a range of channels that involve the transmission of ideas and new technologies. Also, diffusion of knowledge takes place when highly skilled staff previously employed in the subsidiary move thus resulting in demonstration effects where domestic firms observe and imitate superior technology in subsidiaries, or purposeful transfers of knowledge from subsidiaries to local suppliers and clients.

Numerous studies find that technology plays a key role in generating spillovers in the form of improved productivity. However, the larger the technological gap between MNC and domestic firms, the less likely are spillovers to happen. Hill (2008) argues that economic development can be highly stimulated from the support of technology in two different forms: incorporated in a production process or incorporated in products. However, the fact is that many developing countries do not have enough required skills, research and development resources to improve their products and use the advantages of technology in producing commodities and life. Countries around the world have developed their technological learning through different approaches. According to Kim (2001) two of these approaches are learning by research and learning by doing. The first approach is more linked with the developed countries, which build a strong scientific and technical infrastructure, and they are in the process of pushing the scientific frontier. The second approach is more linked to this study and applied by developing countries through imitation and replication of foreign technical achievements. The process of technology transfer in these countries is supported by local efforts in

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115 Kim, L (2001), The dynamics of technological learning in industrialization, International Social Science 168: 297-308
education, and training to develop the absorptive capacity and technological capabilities. The evidence on technological spillovers is diverse and thus calls for additional and more definitive evidence for example, Kinoshita & Chia-Hui (2006); Barba Navaretti & Venables (2004); Gorg & Greenaway (2004). A lot of empirical research supported the idea that FDI has positive technological spillover effects, direct or indirect, where spillover effects stirred serious competition, resulting in local enterprises in improving their efficiency.

1.7.2 Capital leads to more investment

One of the significant benefits of FDI to the host country is capital. This can be explained in two ways. First as a source of financing, directly by the increase of capital accumulation and income beyond available local resources as when MNCs enter a sector where many domestic firms already exist. However if MNCs enter an underdeveloped sector, it will create complementarities with the domestic firms. This is due to MNCs having a lot of capital and access to international capital markets, although some scholars argue that MNCs do not transfer much of their own capital, rather most of investments are financed locally since FDI is an expensive source of finance and all profits are repatriated. Second mobilizing local savings pushes local firms to increase their investment defensively in order to face competition. However, some scholars argue that FDI may lower domestic savings and investment, including via profit repatriation; crowd-out domestic companies; increase demands for foreign exchange; supporting local oligopolies and be monopolistic; distort local politics, spoil regulation; and create instability through increased financial volatility.

1.7.3 Marketing techniques lead to enhanced exports

FDI has been used as a market entry strategy for investors. According to UNCTAD, despite the decline in trade barriers, FDI growth has increased at a higher rate than the level of world trade as businesses attempt to circumvent

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117 Include all unintentional technological benefits generated by an MNC in the host country.
119 Markusen and Venables (1999); Driffield and Munday (2000).
120 De Mello (1999).
protective measures through direct investments. With globalization, the horizons and limits have been extended and companies now see the world economy as their market. Moreover, FDI can affect the host country through exports using different techniques for example branding, promotion and networking. This can be seen in two main types of effects. First there are direct effects, which refer to an increase in the host country exports, affected by the MNCs firms themselves exporting. Evidence demonstrates that MNCs significantly contribute to the exports of a country. This is because the larger productivity of MNCs allows them to face the sunk costs of exports as well. Such macroeconomic effects could moreover be influenced by the motivation behind the different types of FDI. Vertical FDI refers, by definition, to locating the different production stages in different countries in order to realize efficiency gains. In that case, exports of intermediate goods by multinational firms can be expected to increase, consequently increasing the total exports of the host country. Another type of FDI, export-platform FDI, refers to MNCS entering a foreign country with the objective of exporting to a third country. This type of FDI can be justified by the desire to take advantage of lower exporting costs between the host and the third country than those incurred by exporting directly from the home country. Obviously this type of FDI would result in an increase in exports for the host country. Additionally, assuming a multi-product firm, there can be some complementarities between exports and FDI. Horizontal complementarities would occur when the demand for the product supplied by foreign firms leads to an increased demand for more or all goods produced by the same firm, possibly resulting in some of them being supplied through exports, the second type of FDI effects on the exports of the hosting country are indirect. For example, this can occur via the competition effect mentioned in the previous point, as the increased competition following the entry of a foreign affiliate is expected to force domestic firms to become more productive (or exit),

122 FDI and exports are substitute ways of serving a foreign market.
therefore allowing some of them to start exporting. This argument is in line with the firm heterogeneity theory presented in the previous section, stating that exporting induces sunk costs, which only the most productive firms can bear. Furthermore, the presence of foreign affiliates can ease the entry of local firms in foreign markets, due to information externalities. By definition, MNCs are present in different markets in different countries and therefore possess some experiential knowledge about foreign markets, resulting in lower sunk costs of exports for them. If their knowledge about foreign markets is transferred to the local enterprises, export spillovers could occur as it would also reduce the sunk costs of exports for local firms, consequently enabling more firms to face them. Also, export spillovers may occur as a second-round effect following an increase in productivity associated with the presence of foreign-owned firms. For instance, by adopting a foreign technology, a local firm can increase its productivity and therefore its competitiveness on the global market, allowing it to face the extra costs of exporting.

1.7.4 Competition leads to improved efficiency in domestic market

Wang and Blomstrom (1992); Glass and Saggi (1998) highlighted the competitive effects as additional mechanism of spillover. According to their arguments the FDI raise competition in domestic markets. If these are imperfectly competitive, this may influence local companies to use present technology more cost-effectively, resulting in productivity gains. Moreover, rise in competition could increase the speed of adoption of new technology or the speed with which it is imitated. In general, FDI particularly in the form of greenfield investment increases the level of competition in a market, which drives down prices, reflected in an overall improvement of the consumer welfare. In the same sense, increased competition can lead to increased productivity growth, product and process innovation and greater economic growth. According to Griffin and Pustay (2001) in the long term competition

enhances productivity growth, and increases economic growth.\textsuperscript{128} In contrast, Aitken and Harrison (1997) claim that MNCs can also reduce productivity of local companies, mainly in the short run. If imperfectly competitive firms have to face fixed costs of production, a foreign firm with lower marginal costs will have motivation to raise its production relative to its local competitors. In this case, MNCs producing in the local market can draw demand from local companies, and therefore the productivity of local firms would collapse. If the productivity decline from this demand effect is high enough, net local productivity can decrease even if the foreign firm transfers technology or its asset to local firms. Nevertheless, some scholars argue that intense competition and dominating the market result in crowding out\textsuperscript{129} small and medium domestic enterprises (SME).\textsuperscript{130} MNCs presence also affects the profitability of domestic investment, as MNCs draw demand from the less efficient domestic firms, thus forcing them to cut production, and therefore costs go up.\textsuperscript{131}

1.7.5 Best practice and skill lead to higher labour productivity

In most countries, FDI is considered to be an important element of strategy that deals with one crucial economic and social problem, which is unemployment, by creating new job opportunities and reassigning labour productivity, as it has been confirmed by preliminary evidence that MNCs tend to invest more in personal training as compared with local companies.\textsuperscript{132} However, the influence of labour mobility on the efficiency of local firms is hard to assess, as it necessitates tracking the workers in order to inspect their impact on the productivity of other workers.\textsuperscript{133} Therefore, there is a shortage of detailed


\textsuperscript{129} This happens when there is a large technological gap and the labour force in the host country is not sufficiently qualified (Kokko, 1994; Borensztein et al., 1998); also because of differences in the access to credit between foreign and domestic firms

\textsuperscript{130} De Backer and Sleuwaegen (2003); P. 67

\textsuperscript{131} Aitken and Harrison (1999)


studies in relation to this specific aspect.\textsuperscript{134} Hill (2008) proposes that there are two ways that FDI affects employment, directly and indirectly. When a MNCs comes to establish even an acquired or a greenfield operator, a huge number of workers are employed to work for the firm, which translates into direct effects of FDI.\textsuperscript{135} However, Jenkins (2003) criticizes that when FDI involves the acquisition of local firms rather than greenfield investment, there is no rise in employment; employment is even likely to fall if the foreign owner subsequently rationalizes the firm. The indirect effects arise when jobs are created in many other fields of business in order to supply the investment field. Besides, as MNCs employees increase their spending, it also increases jobs for particular local markets near the foreign firms.\textsuperscript{136} However, cynics argue that not all the new jobs created by FDI represent net additions in employment. It is popularly supposed that when a MNC enters to run business in the host country, it creates thousands of jobs but on the other hand, due to huge advantages as mentioned above, MNCs may take over the market share and therefore internal firms’ business will go down, leading to significant downsizing in employment. As a consequence of this substitution effect, cynics claimed that the number of job opportunities created by FDI might not match that promised by MNC at the beginning.\textsuperscript{137}

In other cases, when a MNC decides to open business as an acquired operator in the host country, an action that it is likely take is to restructure the firm in order to improve its operating efficiency. Therefore, a huge number of employees will lose jobs or be replaced due to inappropriate ability and lacking job skills. However, this just the primary effect of the whole reforming process. Once, the adjustment period is over, the MNC tends to grow faster and as a result it also employs many more workers and perhaps even more than the domestic operators.\textsuperscript{138} When MNCs provide training and work experience to


\textsuperscript{135} Hill, W.L.C (2008), ‘The benefits of FDI to host countries, Global business today, 5th edn, McGraw-Hill/Irwin, USA, pp.359-396

\textsuperscript{136} For example, when Toyota made a decision to establish a new auto plant in France in 1997, estimates indicated that the plant would create 2,000 direct jobs and possibly another 2,000 jobs in support industries.

\textsuperscript{137} Cynics, S 2007, “Home and host country effects of FDI”, National Bureau of economic research, working paper no. 9293, pp. 393-413

\textsuperscript{138} FDI has different impact on employment in the short and long term.
local workers, instead of replacing them, such workers either migrate to another local firm with their newly acquired knowledge in search of better salary or start their own business.\textsuperscript{139} Aitken and Harrison (1999) analysed Venezuelan manufacturing industry enterprises; they found FDI could not only result in labour productivity spillovers effects of domestic capital enterprises, but also lead to lowering their labour productivity. Furthermore, a few studies have shown increased unemployment rate as FDI increases wages and the price of locally supplied inputs by displacement of domestic firms. In contrast, it is important to stress a possible negative impact arising through this channel, as MNEs may attract the best workers from domestic firms by offering higher wages.\textsuperscript{140}

1.7.6 Management leads to better control on time and quality

It is essential for MNCs to have a good team with higher management skills to be able to run business in foreign countries. These managements are trained in the latest management techniques, offering improved work ethics in the companies in the host country. The spillover benefits may result from interaction between local employees and MNC employees who are trained well to take important positions in management, financial or technical. Furthermore, MNCs have advantages of passing some efficient management styles to local suppliers to ensure high quality and timely delivery of their input as domestic firms upgrade their production management. Hill (2008) and Braconier et al (2001) take the argument further by adding that some local labour force may ultimately leave the company after being trained in modern management techniques, which results in the opening up of many more employment opportunities.\textsuperscript{141}


\textsuperscript{141} Hill, W.L.C (2008), ‘The benefits of FDI to host countries, Global business today, 5th edn, McGraw-Hill/Irwin, USA, pp.359-396.
1.8 Spillover Methods and Mechanisms

According to the literature, the potential effects are transmitted through four different channels: market transactions, demonstration effect, labour mobility, business linkages and competition. From a theoretical perspective, the entry of FDI may affect domestic companies through several mechanisms see figure 1.1.

Figure 1.2: Productivity Spillover Mechanisms

Source: Compiled by author

1.8.1 Demonstration effect

Demonstration effect relies on real externalities, such as new technologies, new marketing techniques, and new types of products, when local firms learn through observation and imitate the multinational corporations, incorporating this learning into local conditions. New technology often includes uncertainty and necessitates large investments which smaller local firms are not willing to undertake. However, foreign firms prove that the technology is profitable, thereafter reducing uncertainty and giving incentives for local firms to adopt it. This is what is called the demonstration effect. Obviously, the adoption of the new technology necessitates that the local firms possess a certain level of knowledge and advancement. Many scholars confirm positive effects in

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142 Navarette, Giorgio Barbra & Venables, Anthony J. (2004), Multinational Firms in the World Economy; Princeton University Press.

relation to FDI presence in a sector and demonstration mechanisms. Various definitions of demonstration effects can be found in the literature. Saggi (2002) defines demonstration effects as occurring through the imitation and reverse engineering of a multinational enterprise’s products and practices by local firms. Many of the studies reviewed by Go¨rg and Strobl (2001) and Go¨rg and Greenaway (2004) implicitly deal with knowledge spillovers through demonstration effects, as the majority look for horizontal (intra-industry) knowledge spillovers. By (Saggi’s) definition demonstration effects occur mainly through these horizontal spillovers. This spillover mechanism involves that the goods produced by local and foreign firms are to some extent similar. The larger the difference between the goods, the less relevant is the foreign technology for the local firms, reducing the incentives to adopt it. Additionally, for these spillovers to occur via a demonstration effect, a minimum level of knowledge from the local firms is required. Moreover, it requires some kind of similarities between the goods produced. If these conditions are not met, local firms will most likely fail to adopt the new knowledge brought up by foreign affiliates, consequently reducing the amount of positive spillovers induced by their entry.

Figure 1.3: Demonstration effect

Source: Compiled by author

144 Caves (1974); Haddad and Harrison (1993); Aitken et al. (1996); Aitken and Harrison (1999); Djankov and Hoekman (1999).
1.8.2 Labour Mobility

Labour Mobility is possibly the most important channel for spillover, although it is difficult to confirm since it would involve following individuals who have worked for MNCs and then determining their impact on the productivity of the new local employers. Normally, multinational firms use skilled labour in order to possess a comparative advantage in the foreign market and so to circumvent the extra costs associated with FDI. Moreover, evidence shows that in order to protect their firm-specific assets and to prevent high labour turnover, multinational enterprises (MNCs) pay on average higher wages than domestic firms. Spillovers arise when trained local employees move to local firms or start their own entrepreneurial business.

Figure 1.4: Labour Mobility

Studies show both positive and negative effects in relation to labour mobility in both short and long-term effects, such as on employment.

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147 Labour mobility or labour turnover refers to facilitating human capital formation in local firms
Fosfuri, Motta, and Ronde (2001) construct a model where spillovers result from labour mobility. Technological spillovers arise when the local firm hires the trained worker. More labour mobility and spillovers accrued when local firm can operate in markets for product, which are unrelated or complimentary to the MNE’s product. They also found that the spillover is more likely to happen when on-the-job training is general rather than specific, and when the absorptive capacity of the local firm is high. As another labour-market-related aspect, labour market legislation in the host country would be a decisive aspect for productivity spillovers via labour turnover, as more restrictive laws regarding mobility of labour would reduce the extent to which knowledge would be spread by previous employees of foreign affiliates. Moreover, laws regarding property rights could also impact the extent of such spillovers, as more restrictive policies in terms of higher property rights protection would prevent the workers to use their knowledge acquired via foreign training in domestic firms, especially if they are employed by direct competitors. Also, the type of training provided by the MNCs influences the extent of spillovers, as the acquisition of more firm-specific knowledge results in less mobile workers due to a lower outside-value caused by its lower transferability. Spillovers via labour turnover are more likely to occur in cases where the multinational and the local firms are not directly competing, where the knowledge acquired is more general, and where the foreign wage premium is lower.

1.8.3 Business Linkages

Spillovers can occur via the interactions between multinational and local firms, as MNCs can help the host economy through the backward and forward linkages they generate through market transactions. Linkages in our study context are defined as linking FDI companies not only with domestic ones but also with research institutes, academic and other institutes of mutual benefit. In this respect, two types of linkages exist: First, backward linkages, MNCs can

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152 Negative in the short and positive in the long run.


154 The transfer may take the form of licensing agreement for particular technology, or as part of upgrading associated with supply of inputs, assembly, or marketing (Navaretti and Venables, 2004)

155 Stemming from the relationship between the multinational firms and their suppliers
have positive influences on the productivity of their suppliers in different
conducts. These linkages could benefit the host country if foreign affiliates
switch towards local suppliers. As demonstrated by Lall (1980),\textsuperscript{156} MNCs may
have incentives to provide technical assistance to or share knowledge with their
local suppliers in order to improve and ensure the quality of the goods
purchased. Additionally, they could be motivated to provide training and help
domestic firms with regard to management and organizational practices, in order
to enhance their suppliers’ efficiency. Additionally, multinational firms could
impact the productivity of their suppliers via the increased demand for their
products, perhaps allowing them to realise economies of scales and become
more efficient.\textsuperscript{157} Finally, the venue of a foreign-firm might create competition
among the potential suppliers in order to be chosen by the multinationals. If this
competition results in innovation on the part of the suppliers, one could view this
as a positive effect from foreign direct investment.\textsuperscript{158} Second, Forward
linkages.\textsuperscript{159} These arise from the interactions between the MNCs and their local
customers. Such interactions can improve the productivity of local firms if, for
example, the MNCs supply goods of higher quality/lower price to domestic
producers.\textsuperscript{160} Nevertheless, it seems obvious that for such spillovers to arise, it
is required that the motive of foreign investors is to sell in the host markets and
not only to take advantage of efficiency gains and re-export to their home
country. In general, FDI can be classified as vertical or horizontal depending on
the objective of the firm and the nature of production process, as there are two
main objectives why a company wants to become a multinational one. The first

\textsuperscript{156} Lall, S. (1980), Vertical inter-firm linkages in LDCs: An empirical study, Oxford Bulletin of

\textsuperscript{157} Crespo, N., Fontoura, M.P. (2007), Determinant Factors of FDI Spillovers – What Do We

\textsuperscript{158} Absorptive capacity of domestic firms is important as they need some minimum knowledge in
order to be able to introduce the changes suggested by foreign affiliates in downstream
sectors. However, backward linkages might not require absorptive capacities as high as the
demonstration effect for productivity spillovers to be realized. This is so given that help from
foreign affiliates is provided to domestic firms in order to ensure the higher quality of the goods
purchased.

\textsuperscript{159} Referring to the relationship between the foreign firms and their customers.

\textsuperscript{160} Markusen, J.R., Venables, A.J. (1999), Foreign Direct Investment as a catalyst for
industrial development, European Economic Review, Vol.43, pp.335-356
reason is to better serve the local market and the second one is to get lower cost inputs.\textsuperscript{161}

A. **Horizontal Direct Investment,\textsuperscript{162}** occurs when the MNCs enter a foreign country to produce the same products as at home. In this case FDI becomes expensive because a firm must bear the costs of establishing production facilities in a foreign country or of acquiring a foreign enterprise. Moreover, MNCs accept a high risk because of the problems associated with doing business in another culture where the rules of the game may be different. Horizontal FDI is usually undertaken in countries with relatively large markets because the fixed costs per unit of production in those markets are significantly lower. Moreover, countries with large markets tend to have much fiercer domestic competition, which drives the prices down and makes the imported goods uncompetitive due to the extra transportation and tariff costs.\textsuperscript{163} However MNCs choose horizontal FDI because transportation costs are high (Internalization Theory), trade barriers (actual or threatened) impede the free flow of goods and services or in response to actions of a competitor/strategic rival in response to shifts in the product’s life cycle or because of location specific advantages (e.g. natural resources).

B. **Vertical Direct Investment,\textsuperscript{164}** usually includes moving certain segments of the production process in countries with lower labour costs or available raw materials and commodities necessary for the production. Vertical FDI is often export-oriented, typically to the MNCs home countries and tends to be unaffected by the size of the host market. Generally, vertical FDI is preferred when the different parts of the production process have different input requirements and input prices vary among countries. The MNC produces intermediate goods either forward or backward in the supply stream. This takes two forms,

\textsuperscript{161} Ashraf Mishrif, Investing in the Middle East, Tauris Academic Studies, 2010: P.18.
\textsuperscript{162} When FDI is made in order to serve the local market.
\textsuperscript{164} When a MNC is searching for lower input costs.
a. **Backward vertical FDI** is an investment in an industry that provides inputs for a firm’s domestic production processes.

b. **Forward vertical FDI** occurs when an industry abroad sells the outputs of a firm’s domestic production processes; this is less common than backward vertical FDI

One explanation of MNC choice of vertical FDI is that by using vertical backward integration, a firm can gain control over the source of raw materials and this would allow the firm to raise entry barriers and shut new competitors out of an industry. Another explanation of vertical FDI is that firms use this strategy to circumvent the barriers established by firms already doing business in a country. The market imperfections approach offers two explanations for vertical FDI: there are impediments to the sale of know-how through the market mechanism and investments in specialized assets expose the investing firm to hazards that can be reduced only through vertical FDI. Horizontal linkages tend to focus on relation between MNCs and DCs in the same industry, while vertical linkages occurs between MNCs and DCs in a downstream supplier (backward) or upstream purchaser (forward) as compared to the business that the firm operates in its home country. Backward linkages, which connect local suppliers to MNC customers, provide direct assistance to suppliers, have higher requirements and also offer incentive programmes to promote them.\(^{165}\)

Smarzynska (2002), in Lithuania found that spillovers from FDI took place through backward linkages, i.e. local suppliers, but there was no indication of spillovers in the same industry. The spillovers were larger in domestic-market rather than in export-oriented foreign companies and are not geographically restricted. Full or partial foreign ownership was not found to matter.

As Navaretti and Venables (2004) report and Rodriguez-Clare (1996) developed a formal model of linkages and show that multinationals improve welfare only if they generate linkages over and beyond those generated by the local firms they displace. They highlighted the importance of vertical linkages as a channel for technology transfer from FDI. Moreover, Bessonova, Kozlov, Yudaeva (2002) found in Russia that FDI improved the productivity of domestic

\(^{165}\) While multinationals have a strong incentive to prevent knowledge leakage to their competitors, they may want to transfer expertise and know-how to their suppliers.
firms horizontally through competition and vertically through backward linkages as a result of increased competition and vertical spillovers. In general, spillovers greater potential from vertical than horizontal FDI depends on absorptive capacity, entrepreneurship and bargaining power to accrue benefits to local firms.

**Figure 1.5: Business Linkages**

![Diagram of business linkages]

Source: Compiled by author

### 1.8.4 Competition

One of FDI’s significant advantages to the host country is to lift up the level of competition between firms. As the market share reduces with higher number of firms entering the same business, they are forced to improve product quality, and appearance, as well as lower the price, in order to attract more customers.  

In general, benefits of increased domestic competition are reflected in an overall higher productivity and lower prices for consumers. The entry of multinational firms increases the level of competition within the industry as long as some share of their output is sold in the host country. This increased

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competition is likely to affect the local firms, both positively and negatively\textsuperscript{167}. Indeed, due to MNCs being more productive than the local incumbents, it is rational to expect that the entry of foreign owned firms into a specific market will result in some local firms ceasing their production or losing some market share. Consequently, their productivity would fall as they spread their fixed costs over a smaller market.\textsuperscript{168} On the other hand, this increased competition can have a positive effect on the local firms remaining in the market due to the need for them to innovate and develop more efficient production techniques and resource allocation in order to stay competitive and survive.\textsuperscript{169}

Even host countries with liberal trade regimes may experience an increase in competition. Producing locally reduces labour and transportation costs in emerging markets. As a result, multinationals too can then reduce their products prices as compared to those prevailed before entering the host country. In the long run, increased competition provides incentive for domestic producers to improve their performance; it also leads to the exit of the worst performers and an overall increase in the average productivity in the industry. In the short-to-medium run, however, weaker firms may experience a decline in observed performance as their market share shrinks. Hence the effects can seem negative in the short-run and positive in the long run.\textsuperscript{170} Multinationals may also push the best workers from their local competitors and make access to credit more difficult.\textsuperscript{171} Both channels create negative pecuniary externalities that affect local firms. While pecuniary externalities have a negative impact on the affected firms, they lead to more efficient outcomes for the economy as a whole. As a result of increased competition in product, labour, and credit markets, resources are reallocated from less efficient firms to firms that are better positioned to benefit from them. This in turn may benefit consumers through

\textsuperscript{167} As FDI does not automatically translate to net foreign exchange inflows. To start with, many MNCs investors borrow money locally at favourable interest rates and thus finance their projects. This creates unfair competition with domestics companies and crowds the domestic private sector out of the credit market, displacing its investments in the process.


\textsuperscript{170} De Backer and Sleuwaegen (2002); Sembenelli and Siotis (2005); Hale and Long (2006)

\textsuperscript{171} Because they may be lower-risk borrowers than their local competitors
lower prices. FDI in the form of greenfield investment increases the level of competition in a market, driving down prices, which in turn reflects an improved welfare of consumers. Moreover, increased competition can lead to increased productivity, product and process innovation and, greater economic growth altogether.

**Figure 1.6: Competition (will be insert)**

![Diagram of Competition]

Source: Compiled by author

### 1.9 Pre Conditional Factors for Productivity Spillovers

Literature highlights several potential factors as the key determinants of spillover from FDI. These factors can be classified into factors related to host economy and factors related to MNCs. in this part, we will address the Pre-conditional Factors for spillovers to materialize. See Figure 1.7.
1.9.1 Absorptive capacity

The absorptive capacity of the host country is an important factor affecting the extent of spillover from MNCs; this has been reviewed intensively in the literature.\textsuperscript{172} Within the context of this study it relates both to the capability of local firms to learn and to the supply of factors of production needed for MNCs and local firms to implement superior technology. Absorptive capacity\textsuperscript{173} can be defined as the capability of a local firm to identify valuable new knowledge, adopt it into its current technological development, and adjust it to its own specific uses, processes and routines. However, absorbing existing knowledge is a complex phenomenon, although several case studies show that locals learn from MNCs during their time with them and then apply their newly attained skills elsewhere. However still, copying something requires skill to make it appropriate for the copier. Governments recognize this waste of MNCs resources in improving the skill of their employees, which is eventually used elsewhere, and consider it inappropriate. Findlay’s study (1978) is a pioneering contribution to this literature. It highlighted the importance of relative backwardness referred to

\textsuperscript{172} Abramovitz (1986); Cohen & Levinthal (1990); Nelson & Phelps (1966)

\textsuperscript{173} According to absorptive capacity, spillover depends on the level technological capability of local firms compare to their foreign counterparts.
as the “catching up”. Relative backwardness refers to the distance between two economies in terms of development. His model suggests that the greater the distance between the two economies, the greater the pressure for change and therefore the more rapidly new technology is adopted following the presence of the MNC. It is important to distinguish between absorptive capacity at the firm level and at the country level: an example of the first case the study by Girma (2005), where absorptive capacity was measured as the distance of the firm from the technology frontier firm. In this case, a firm operating close to the technology leader is said to have high absorptive capacity. As for absorptive capacity at the country level, this is where the bulk of the evidence on absorptive capacity is found. Country level studies, identify indicators such as per capita income,\textsuperscript{174} trade openness,\textsuperscript{175} the level of education that the labour force has attained,\textsuperscript{176} the level of development of financial markets\textsuperscript{177}, technology use efficiency\textsuperscript{178} and domestic research and development.\textsuperscript{179} The importance of R&D in expanding the technology frontier is discussed by Aghion and Howitt (1992) and Grossman & Helpman (1991). The dominant variable in most studies is the standard of education of the labour force, which is also described as “social capability”, a threshold level of human capital and human capital formation. In the same line we must accept that not all firms are expected to benefit from spillovers from FDI. The domestic firms must possess sufficient levels of absorptive capacity to efficiently take advantage of spillovers.\textsuperscript{180}Cohen and Levinthal\textsuperscript{181}, Glass and Saggi\textsuperscript{182} argue that firms need some minimum amount of absorptive capacity to be able to capture productivity spillovers. Such absorptive capacity, created by investments in R&D or human capital, provide the basis of fundamental knowledge or technology necessary to assimilate and

\textsuperscript{174}Blomstrom, et al., (1994)
\textsuperscript{175}Balasubramanyam, et al., (1996)
\textsuperscript{176}Borensztein, et al., (1998)
\textsuperscript{177}Alfaro, et al. (2004)
\textsuperscript{178}Fagerberg (1994)
\textsuperscript{179}Griffith, et al. (2004); Kneller,(2005); World Bank,(2001)
\textsuperscript{180}Das, (1987), Wang and Blomström, 1992 and Perez, 1997
exploit external knowledge. Also, Lipsey and Sjöholm in their FDI spillover studies argue that countries and their firms might differ in their capabilities to benefit from the FDI firms. The experience of other countries shows that FDI spillover effects are not automatically generated by opening-up the economy to FDI. Indeed, the spillover effects of FDI to domestic firms have remained limited due to the domestic firms’ weak competitiveness and an overall inability to absorb the technology or knowledge being transferred. This implies that for spillovers to take place, the absorptive capacity of domestic firms must be strengthened. To deepen firm’s linkages within the economy, the development of domestic parts and suppliers would be crucial. In order to improve a nation’s domestic parts and suppliers towards their involvement with foreign affiliates, it is crucial to strengthen the absorptive capacity of human-resource development and necessary training for upgrading their skills. The entire focus continues to be towards industrialization and technological advancement. Perez, (1997, p.175) asserts that “in industries where a relatively wide technological gap is associated with a relatively low and slowly growing foreign share, indigenous firms may be able to catch up gradually. Conversely, where technological disparities are relatively modest but indigenous firms have to cope with a foreign presence that is too high or that grows too fast, the same firms may be unable to compete with foreign rivals and may enter into process of cumulative decline”.

Cantwell (1989) put forward the idea that absorptive capacity of local companies is the fundamental factor to determining the spillover benefits from the presence of FDI. He studied the response of local companies to the rise of competition caused by the entry of U.S. multinationals into European markets between 1955 and 1975 and said that positive spillovers happened only in industries wherein local companies had some traditional technological power. Kokko et al. (1996,p 609) argue that “small and moderate technology gaps seem to identify cases where foreign technologies are useful for the local firms, and where the

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183 Cohen and Levinthal (1989; 1990); Glass and Saggi (1998a)
local firms possess the skills needed to apply or learn the foreign technologies. Large gaps, on the other hand, may signal that foreign technology is not relevant (because the product varieties manufactured by foreign firms are very different from local varieties), that local firms have nothing to learn from the foreign firms, or that local technological capability is so weak that foreign technologies cannot be used in local firms.\(^{187}\)

Abramovitz (1979) argued, while using the concept of absorptive capacity, existence of domestic capability is a pre-condition to assimilate foreign spillovers. Thus, it is quite clear that the process of imitation of frontier technology from advanced countries entails cost and this cost varies positively with the increase in the complexity of knowledge. Obviously, the message from the technology gap theory is that the domestic and international knowledge diffusion involves huge cost. Without sufficient level of domestic capabilities, which requires massive investment, a country is unlikely to benefit from leaders’ technological knowledge and faces the risk of continuously lagging behind instead of catching up.\(^{188}\) Literature stresses the role of absorptive capacity which links to the quality of human capital, and of management, and highlights role of education and management training policies. The following part will highlight five important elements related to Absorptive Capacity.

1.9.1.1 Human Capital

Keller (1996) developed a model that emphasises the role of host country absorptive capacity, defined as the stock of human capital, in affecting technology transfer process. He argues that if a country’s stock of human capital remains unchanged, a switch to an outward orientation does not lead to a higher growth. Glass and Saggi (1998) developed a theoretical model on spillovers from FDI and argue that investment in imitation by host country firms generates the necessary skill foundation for FDI, and thus factors that promote imitation can promote a higher-quality mix of FDI. They complement Keller’s analysis by giving investment in imitation a role similar to human capital accumulation in
Keller’s model. The importance of human capital in this context is based on the idea that higher skilled workers are needed to implement more advanced technologies.

1.9.1.2 Research and Development capacity

MNC investment associated with low technology can be located anywhere but high technology investment can only be located in countries with at least a basic R&D capacity. Hence, local firm R&D capacity effectively constrains a country’s ability to host foreign technology and thus it will be unable to get the benefit from high technology investment. Motivated by Glass and Saggi’s analysis, Kinoshita (2001) conducted an empirical study using data for the Czech Republic and conclude that positive spillovers took place in the R&D intensive sector. In another study, Kathuria (2000) found positive spillovers in scientific sectors but none in the non-scientific sectors for Indian manufacturing industries. Todo and Miyamoto (2002), and Blalock and Gertler (2004a) found that firm’s R&D positively affected the degree of spillover received. In regard to MNCs activities, Todo and Yamamoto (2002) report an important finding that R&D activities and human resource development activities conducted by MNEs stimulate knowledge spillovers to local firms, while spillovers from MNCs without such activities are absent.

1.9.1.3 Technology Gap

Wang and Blomström (1992) advanced a theoretical model that explains the detailed mechanics of FDI spillovers. They incorporated Findlay’s relative backwardness into the learning process of local companies. Nevertheless, their model also shows the importance of the learning efforts of host country firms in increasing the rate at which MNCs transfer technology, the higher the host country’s firm investment in learning, the narrower the future technology gap. As a response, MNCs allocate more resources to transfer more advanced technologies in order to keep there business profitable. Wang and Blomström (1992, p.140) suggest, “Although there is generally some degree of technology spillover between firms, there is no free copying of technologies in the world. Searching for information reversed engineering, personnel training for new
production methods, et cetera, make learning costly and time consuming.” \(^{189}\) Also Narula and Marin (2003) propose that absorption is not only about imitation; local companies cannot engage FDI knowledge without investing in their own research and development, because it can be highly specific to foreign firms, since it is tacit in nature. \(^{190}\)

1.9.1.4 Institutional Framework

Although a lot of countries have been successful in attracting FDI, little have succeeded in answering that FDI strengthens the local economy, particularly local firms which are the backbone of the domestic economy contributing to job creation and income. In fact, a range of institutional factors are needed to ensure achievement of the above objective. \(^{191}\) These institutions deal with all concerned parties: government, local firms and foreign investors. The main roles of these implementing institutions are to improve the policy environment in which the private sector operates to encourage linkages between MNCs and local firms and influence a country’s absorptive capacity. John Dunning in his 2004 study “Institutional Reform, FDI and European Transition Economics” reviewed the significance of institutional infrastructure and development as a factor of FDI inflows into the European Transition Economies. He assesses the critical role of the institutional environment in reducing the transaction costs of both domestic and MNCs activity. Also, in 2005 paper “Foreign Direct Investment in Emerging Markets: A Comparative Study in Egypt, India, South Africa and Vietnam” by Klaus E Meyer, Saul Estrin, Sumon Bhaumik, Stephen Gelb, Heba Handoussa, Maryse Louis, Subir Gokarn, Laveesh Bhandari, Nguyen, Than Ha Nguyen, Vo Hung demonstrate significant differences of the features of FDI throughout the four nations, although all have had restrictive policy regimes, and went through liberalization in the early 1990. The study concludes that the policy makers need to understand how institutional


\(^{191}\) Pradhan, Jaya Prakash, Quality of Foreign Direct Investment, Knowledge Spillovers and Host Country Productivity: A Framework of Analysis, Institute for Studies in Industrial Development, December 2006, Online at http://mpra.ub.uni-muenchen.de/12336/
arrangements may generate favorable outcomes for both the home company and the host economy.

1.9.2 Host country policy Environment

Host country economy and policy environment provide necessary environment for spillovers to take place. A more developed host country economy is associated with a higher absorptive capacity of local firms, better institution, more developed and competitive manufacturing sector and better inter-sectoral linkages, which would increase the potential for spillovers. The empirical studies establish a consistent positive evidence for developed countries and mixed evidence from developing countries support this argument.

One argument concerning host country economy and policy environment is introduced by Bhagwati (1985) who argues the importance of the trade regime. Bhagwati suggests that whether a country adopts an export promotion or an import substitution trade regime will affect the efficiency of FDI spillovers. Moreover, Kokko et al (2001) in an empirical study for Uruguay, and Kohpaiboon (2005) in Thailand provide evidence for the hypothesis. They found evidence of spillovers during the import substitution regime and no evidence during export oriented policy. Blomstr.m et al (2000) discuss the role of investment policy in affecting ownership sharing and the type of FDI in the host country. They argue that other government policies are also considered as important determinants of FDI spillovers. However, Dimelis and Louri (2001) found that minority owned firms benefit more from FDI spillovers in Greece. Furthermore as been seen in OIL theory, Dunning (1993) demonstrates that the investment policy would also affect the type of FDI operated in the host country.

He identifies four types of FDI: Natural Resource Seeking FDI; Market Seeking FDI; Efficiency Seeking FDI; and Strategic Asset or Capability Seeking FDI.

1.9.3 Intellectual Property Rights

Strength of intellectual property rights can affect the extent of spillovers in the host economy in two different directions. First, strong intellectual property rights inspire MNCs to transfer more qualitative and quantitative knowledge to their subsidiaries, which is reflected in increasing knowledge spillover potential. On the other hand, these make it more difficult to capture knowledge spillovers
for example, through imitation. Markusen (2001) investigates the effects of change in intellectual property rights protection on welfare and spillovers in a host developing country. He finds that if the MNCs cannot write an enforceable contract with a local agent, increased intellectual property right protection makes spillovers less likely. Also, Glass and Saggi (2002) show that increased intellectual property right protection in developing countries has a similar effect on multinational enterprises and national firms in industrial countries, which is a discouraging concern for FDI.

1.9.4 Competition in the Host Country or Sector

Blomströ¨m, Globerman, and Kokko (2001) claim that more competition could make MNCs to transfer more high-quality technology to their subsidiaries, which will reflect in increasing the potential for spillover. Theoretical models by Glass and Saggi (1998b), Wang and Blomstro¨m (1992), and others support this view.

1.9.5 Geographical Location

Geographical proximity between foreign and domestic firms is an important element in determining the size and the extent of spillover effects; spillovers are more likely to occur between neighbours than other more distant firms. Literature indicates that being geographically close to the knowledge source is an important condition for capturing spillovers. Scholars such as Girma and Wakelin (2002) argue that many of these channels have a clear location component. The limited geographic mobility of labour, for example, implies that knowledge spillovers through worker mobility are highly localized. Ben Hamida (2006c) has constructed a theoretical model wherein this variable appears among the determinants of spillovers. Geographical proximity is found to have a significant impact on spillovers. These theoretical findings seem to be confirmed for the Swiss case. Domestic firms that are placed near to foreign

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affiliates may be more likely to benefit than others, since knowledge is transmitted more efficiently via local proximity and its transmission costs are assumed to increase with distance.\textsuperscript{195} Thereby, spillover benefits tend to be captured firstly by neighbouring domestic firms, and gradually spread to other, more distant ones.\textsuperscript{196} Aitken and Harrison (1999) studied the idea that spillovers have a regional aspect. Using firm panel data for Venezuela, they argue that regional foreign investment has positive and significant impact on the productivity of Venezuelan firms, while sectorial foreign investment has negative effects. Similarly, Liu and Wei (2006) found evidence of regional intra-industry spillovers from FDI, using firm panel data for China.\textsuperscript{197} Spillovers across Chinese regions are negative and insignificant; this may be due to the existence of barriers to the movement of production and output factors across regions in China. Also, using sector-level data in the UK, Driffield (2004) showed that there are positive productivity spillovers from FDI in the same region, while FDI outside the region has a negative impact on productivity.\textsuperscript{198} Driffield argues that this negative effect is consistent with a negative competition effect from foreign firms outside the region, which is not offset by the positive spillovers at the regional level.

1.9.6 Ownership of the Multinational Enterprise

According to the literature there are five ways in which MNCs choose to enter a foreign market through FDI. These affect the degree of possibility of spillover benefits between MNCs and local firms. They are: international franchising, branches contractual alliances, equity joint ventures and wholly foreign-owned subsidiaries. The MNCs choose to go for production abroad when transportation costs are high, exporting can be unprofitable or/and Foreign Direct Investment may be a response to actual or threatened trade barriers such as import tariffs or quotas.

\textsuperscript{195} Audretsch (1998)
\textsuperscript{197} Liu, X and Wei, Y (2006), Productivity from R&D, exports and FDI in China’s manufacturing sector, Journal of International Business Studies, 37 (4), 544-557
Nevertheless, exporting has few advantages, which are avoiding some of the unique risks facing FDI, joint ventures, strategic alliances, and licensing; also political risks are minimal and agency costs and evaluating foreign units are avoided. In the same line licensing has three major drawbacks, which according to Internalization theory,\(^ {199} \) it may result in a firm’s giving away valuable technological know-how to a potential foreign competitor, it does not give a firm the tight control over manufacturing, marketing, and strategy in a foreign country that may be required to maximize its profitability and it may be difficult if the firm’s competitive advantage is not amendable. The MNC favours FDI over licensing when it wants control over its technological know-how, operations and business strategy and the firm’s capabilities are not amenable to licensing. The licensing is common for firms in the same industry to have similar strategic behavior and undertake foreign direct investment around the same time and direct their investment activities towards certain locations at certain stages in the product life cycle. Licensing is a popular method for domestic firms to profit from foreign markets without the need to commit sizable funds.\(^ {200} \) In this respect, investment policy related to government restriction on the extent of foreign ownership is important. On the one hand, ownership restrictions should reduce

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\(^ {199} \) Also known as market imperfections.

FDI inflows and therefore, the technology that would accompany those inflows. On the other hand, the restriction might encourage a substitution of other forms of investment such as joint venture. If the strategic alliances facilitate the increased utilisation of foreign technology, the ownership restriction will increase the technology spillovers. Some studies examine the relation between multinational enterprise ownership and spillovers. Müller and Schnitzer (2006) study the theoretical relation between spillovers and multinational enterprise ownership when the multinational enterprises engage in an international joint venture with the host-country firm. They document a trade off in which a larger ownership share induces the multinational enterprise to transfer more technology to its subsidiary, increasing spillover potential but reducing the extent to which the host-country firm is exposed to the technology. The actual relation between multinational enterprise ownership and spillovers studied by Blomström and Sjöholm (1999) who studied 13,663 manufacturing firms in Indonesia in 1991; they found that minority and majority FDI shares had equal spillover effects. In the same country Blalock and Gertler (2008) argue that the productivity effect occurs from investments with joint foreign and domestic ownership but not from fully owned foreign affiliates. Also, Dimelis and Louri (2002) studies 4,056 manufacturing firms in Greece, in 1997, they found that minority FDI shares had greater spillover effect than majority FDI shares. Javorcik (2004) studies 4,000 firms in Lithuania, 1996–2000, and found that Shared foreign and domestic ownership had positive spillover effect. In addition, Javorcik and Spatareanu (2008) studies 13,129 firms in Romania, 1998–2003, and found that shared foreign and domestic ownership had positive vertical spillover effect and negative horizontal spillover effect. Abraham, Konings,
and Slootmaekers (2007) studied 17,645 plants in China, 2000–04; they found that Minority FDI shares had greater spillover effect than majority FDI shares.\(^\text{205}\)

### 1.9.7 Motives for MNCs

Scholars have recently pointed out different types of reasons for MNCs such as motivated by a desire to source or seek external foreign knowledge.\(^\text{206}\) Firms engaging in technology-seeking FDI try to capture spillovers from firms in the host countries in which they invest. Knowledge spillovers are expected to flow from local firms to the multinational enterprise instead of the other way round.

FDI can also be classified as horizontal e.g Markusen (1984),\(^\text{207}\) vertical e.g Helpman 1985, or as export platform e.g Ekholm, Forslid, and Markusen (2007).\(^\text{208}\) Horizontal FDI is usually motivated by market-seeking incentives. Similarly vertical FDI is motivated by efficiency/resource-seeking incentives, and export-platform FDI is motivated by the desire to find an efficient location from which to increase export profits to third-world-countries. The extent of knowledge spillovers from these types of FDI may differ.\(^\text{209}\)

Dunning (1993) demonstrates that the main motivation of the natural resource seeking FDI to invest abroad is to acquire particular resources at a lower real cost than could be obtained in their home country. For market-seeking FDI the motive to invest in a particular country or region is to supply goods or services to markets in these or in adjacent countries, to protect the existing market or to promote new markets. The intention of the efficiency seeking FDI is to take advantage of different factor endowments, cultures, institutional arrangements, economic systems and policies and market structures. The motive for strategic asset seeking is to exploit specific cost or marketing advantages over their competitors to add to the acquiring firm’s

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\(^{206}\) Dunning and Narula (1995); Kuemmerle 1999; Fosfuri and Motta 1999; Siotis 1999; Le Bas and Sierra 2002


\(^{209}\) Javorcik and Spatareanu (2005); Driffield and Love (2007)
existing portfolio of assets, which they perceive will sustain or strengthen their overall competitiveness or weaken the competitiveness of their competitor. Moreover, Nunnenkamp and Spatz (2003) argue that the role of FDI in enhancing host country economic growth will be affected by the different motives of FDI, in particular, between resource-seeking, market-seeking, and efficiency-seeking FDI. Also, Protsenko (2003) examines the spillover effects of horizontal and vertical German FDI in the Czech Republic. He finds that vertical FDI generates positive spillovers, whereas horizontal FDI has effects largely through increased competition. These results suggest that the distinction between horizontal, vertical, and export-platform FDI is potentially important in determining the extent of knowledge spillovers. In summary, by comparing theories discussed earlier such as the internalization theory, Vernon's product life cycle theory, and Knickerbocker's theory of FDI to name a few. Dunning’s eclectic paradigm (OLI) seems to be the best framework to explore the relation and interaction between FDI and the Private sector. These theories suggest the motivation for FDI to meet different objectives, which could be:  

1. Natural resource seeking; looking for resources at a lower cost, this includes oil and gas extraction, mining, and fisheries or lower labor costs for investing companies. For example, a German company opening a plant in Slovakia to produce and re-exporting back to Germany.  

2. Market-seeking; secure market share and sales growth in target foreign market, this is more common in horizontal FDI, allowing access to domestic or regional markets such as EU, NAFTA, ASEAN and GCC market. Similarly, there is a unique possibility for some types of services for which production and distribution have to be contemporaneous (telecom, water supply, energy supply). Automotive TNCs have invested heavily in China  

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211 The move of FDI to emerging markets continued to increase in 2011, with Africa and Latin America and the Caribbean recording the fastest growth in inward FDI. From a global perspective, FDI is largely market-seeking, which justifies why the economic areas with the best economic growth prospects are attracting a larger share of global FDI. This trend is amplified by resource-seeking FDI, with Africa, Latin America and resource-rich countries in Asia attracting more investment.
3. Efficiency seeking; seeks to establish an efficient structure through useful factors, cultures, policies, or markets. To achieve an efficient allocation of the firm’s international specializations, firms seek to benefit from the differences in product pricing therefore reducing the risk of global sourcing. This method greatly improves efficiency by rationalizing the structure of their global activities and is noticed primarily in network based MNCs with global sourcing operations. This trend is also known as vertical FDI, which maximizes production industry gains by efficiently using comparative advantages of different locations. These are also export-oriented FDI.

4. Strategic-asset seeking; seeks to acquire assets in foreign firms that promote corporate long-term objectives. Mostly through access specific or created assets such as technology, brand name, specialized skills. MNCs pursue strategic operations through the purchase of existing firms and/or assets in order to safeguard specific advantages to sustain or advance its global competitive position\textsuperscript{212}.

1.10 The Role Government in Enhancing Productivity Spillover

Government interventions are essential for creating an environment conductive to sustainable spillover through policies and regulations that support the interest of both MNCs and domestic companies. The role of the state is crucial in two aspect, first to attract the right volume and kind of FDI and second, which is more important to tap FDI to promote economic development in terms of their own endowments and development objectives. This is of particular importance for countries that do not have a well-developed private sector, where may also be a case for the Government to take the lead. This will not happen by only offering a passive open door regime for FDI. In fact it need to create a conducive policy environment that enables FDI to contribute towards enhancing the performance of the domestic private sector and the international competitiveness of the local economy on the basis of a dynamic development of comparative advantage. The Monterrey Consensus (2002) gives a strengthened

\textsuperscript{212} Acquisition of key established local firms, acquisition of local capabilities including R&D, knowledge and human capital, acquisition of market knowledge, pre-empting market entrance by competitors and pre-empting the acquisition by local firms by competitors
role to the State with regard to the private sector and markets, particularly in terms of setting appropriate frameworks to regulate markets. Any spillover programme can offer substantial mutually beneficial opportunities to MNCs and domestic companies. On one hand MNCs benefit from linkages with domestic firms because this can reduce cost, enhance access to local assets, increase affiliates specialization and flexibility, adapt technologies and products and facilitate rooting in the local setting. On the other hand, spillover can be one of the fastest and most effective ways of upgrading domestic firms, through traditional spillover benefits such as transfer of technology, skill, management practices and others.

The key issue about the role of the Government is not whether it should intervene but the kind and time of intervention, including direct participation if there is insufficient capacity in the local private sector. It is true that economic and investment-friendly policies are necessary, although not sufficient because government needs to create conditions as well as be proactive in developing these new drivers to attract international production and services, at the same time, to promote domestic private investment to benefit from the FDI.213The main advise in the United Nations report, 2001 of the panel on high-level financing for development to FDI recipient countries is not to differentiate between local and foreign investors and exempt foreign investors from domestic laws which regulate corporate and individual behaviours, or to use costly and discretionary investment incentives or those that erode labour and environmental standards. In the same line, the report suggests that developing countries needed to continue improving their attractiveness to FDI through positive actions in terms of improving standards of accounting and auditing, transparency, corporate governance and public administration rather than through tax concessions, which should be regulated and discouraged. Moreover, the fundamental issue here is to build production linkages between MNCs and domestic firms to enhance their efficiency. Investment promotion increasingly needs to improve and market particular clusters that appeal to potential investors in specific activities. The more targeted and fine-tuned the

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213 Opening up an economy is only the first step, and no longer enough to attract sustained flows of FDI and upgrade the quality.
approach, i.e., matching the specific functional needs of corporate investors with specific locational products, the more costly it is. It takes time and also requires sophisticated institutional capacities. Governments can encourage the creation and deepening of such linkages when they are economically desirable by lowering the costs and raising the reward for linkage formation for both MNCs and local firms. The standard way has been through fiscal, financial and other incentives to forge local linkages in developing countries. Assuming an overall economic and political policy environment that is conducive to investment, the most important factor influencing linkage formation is the availability of local suppliers with competitive costs and quality. In order to absorb and benefit from the knowledge it is essential that those linkages can transfer the technological and managerial capabilities of domestic firms. In this concern, policy measures to strengthen the legal and institutional frameworks for linkage formation have become necessary. The traditional tools to promote linkages like local content requirements, restrictions on sales of goods and services in the territory where they are produced, a requirement to transfer technology and employment performance are no longer permissible in the context of the WTO and other agreements such as the Free Trade Agreement. At the same time, policy measures need to nurture and sustain SMEs as well as to sustain institutions that provide financial, technological and training support in the process of fostering the development of viable suppliers, as well as sources of growth of the economy in their own right. There are areas where state intervention is essential to enhance spillover between MNCs and domestic companies, these may include:

1. Market: Guaranteeing the accuracy of market and business information of linkage formation that could cover names and profiles of supplier information, product price information and a range of up-to-date databases depending on individual country strategies;
2. Matchmaking: For example facilitating one-to-one MNC-supplier encounters and negotiations, acting as honest broker in negotiations and helping with bureaucratic processes;
3. Technology: Facilitating technology upgrade in various ways, including technology transfers as a performance requirement, partnerships with foreign affiliates in technology upgrading programmes and strengthening inter-firm linkages in training;
4. Supplier: Promoting supplier associations for private sector training programmes and collaboration with international agencies;
5. Legal: Legal protection against unfair contractual arrangements and other unfair business practices, including an effective competition policy;
6. Finance: encouraging the support by foreign affiliates to domestic suppliers through fiscal incentives, co-financing or guarantees, and in some cases monetary incentives.
7. Manpower: creating high-level technical manpower geared closely to activities desired by the Government.
8. SME: which Governments at all levels of development have supported through selective measures to level the playing field in relation to large firms.

There is an important role for well-designed country policies and programmes. There are many examples of successful countries in spillover between MNCs and domestic companies, although special care must be taken when drawing lessons from experiences of different countries as some strategies only work in particular contexts, making them difficult to apply to different settings. These may include:

- The National Linkage Programme of Ireland act as essentially a brokerage service to promote local sourcing by MNCs
- The Industrial Linkages Programme of the Small and Medium Industries Corporation of Malaysia including the Global Supplier Programme, which covers a range of areas including training, product development and testing
- The Czech Republic’s National Supplier Programme, a programme that includes collection and distribution of information, matchmaking and upgrading of Czech suppliers.
- Singapore’s, programme that shared salary costs of experienced engineers and managers of MNCs, who agreed to assist in supplier upgrading activities.
- In Taiwan the programme subsidized training and technology consultations to enhance supplier capacity.
The United States and Singapore, as they don’t have sufficient skilled personnel it may well be advantageous to attract the best brains with proper incentives.

Singapore and Malaysia have done condition in some sectors, be it in the form of joint-venture partners or supporting collaboration efforts by the local private businesses with foreign investors.  

Another important element in this regard, a new growth driver in the “knowledge economy” is intellectual property (IP), and its management cuts across industries and involves IP creation, protection, use, valuation and technology transfer. The global agreement on IP is part and parcel of WTO membership. Moreover, there is also a need to reorient educational policies to develop skills that are locally or internationally demanded. Governments need to be proactive in terms of forging linkages between international and domestic firms through lowering the costs and raising the reward for linkage formation for both the MNCs and the local firms.

\[214\textsuperscript{a}\] Asian Productivity Organization, 2002
Chapter 2
The Growth of FDI and Economic Development

The discovery of oil was a turning point in the history of Oman. The previously tribal and poor lands of the Arabian Desert suddenly became one of the major global exporters of oil. As oil and gas revenue became the predominant source of national income, there were major implications for the politics and economic environment of Oman.215

This chapter aims to provide better understanding of the growth of FDI in economic development from Global, Regional and Omani perspectives. Trend analysis216 will measure the change in the volume, source and distribution of both FDI flows and stocks.217 Pattern analysis will measure change in the form of FDI and the sector composition of FDI shift from extractive industries and manufacturing to services as well as theories and reasons behind the change in the FDI trends and patterns. The analysis will be based on documents published by international organizations such as UNCTAD and the Organization for Economic Cooperation and Development (OECD), the World Bank, the International Monetary Fund (IMF) and Omani foreign investment survey carried out by the Omani Ministry of National Economy (MONE) in collaboration with the Ministry of Commerce and Industry (MOCl), and Central Bank of Oman (CBO), during 2002-2014. To achieve this, the chapter will comprise three sections. The first section will explain the FDI trend and pattern on a global level, where it will provide detailed analysis of the FDI trend and its distribution and shed light on the trend of policy change, FDI direction, sources, modes of entry, industry and components. This will lead to the second section where the analysis will be focused on the FDI trend and pattern of GCC countries. The third section will be devoted to discussing the FDI pattern and trend in the Omani context, including the business environment and the status of

215 Oman Country Profile, (2008), the Road Ahead for Oman, Economic Research Forum

216 Trend analysis calculates the percentage change for one account over a period of time of two years or more, while Pattern analysis captures an abstraction of a situation.

217 Flow of FDI refers to the amount of FDI undertaken over a given time, Balance of Payments (BOP) transactions, while Stock of FDI show the total accumulated value of foreign-owned assets, International Investment Position (IIP) aggregates.
Oman in international organisation rankings. In addition, it will cover a variety of Omani policy initiatives that have been used to attract FDI and enhance productivity spillovers to the domestic economy.

2.1 Global FDI In Flow: Trends and Patterns

On the global level there is a clear rising trend in the pattern of FDI flow and stocks during the last three decades. However, our study will focus on the last decade from 2002 to 2011. The World Investment Report by UNCTAD (2012) indicates that global FDI flows rose by 143 per cent in 2011 to $1,524 billion, up from $627 billion in 2002, compared with a 19% inflow rise in 2010. In the same direction global FDI stock rose by 172 per cent in 2011 to $20,438 billion, up from $7,501 billion in 2002, compared with a 3% rise in 2010. These increases were faster than the rise of other economic aggregates like world production, capital formation and trade. There are some explanations for this pattern. First, firms are worried about limiting measures, and see FDI as a way of getting around trade barriers. Second, changes in the economic and political policies of many countries have opened new markets to investment. Third, many firms see the world as their market now, and are therefore expanding wherever they feel it makes sense. However, FDI global level is still 20% below the pre-crisis level. According to UNCTAD, foreign direct investment flows increased for several consecutive years to reach an unprecedented peak in 2007, amounting to USD 1,833 billion. This trend then started to decline as a result of simultaneous economic slowdown in the world’s three largest economies, the United States of America, Japan and the European Union.

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218 As growth opportunities in foreign markets that may not be available in the local market. Many manufacturers are expanding into foreign countries to take advantage of lower labor cost, or to be closer to customers.

219 It is due to that the favorable macroeconomic situation from 2003 to 2007 and the increasing performance of businesses during that period are at the origin of this growth.

220 result of global financial and economic crisis of 2008-2009
Likewise, inter-regional FDI between developed countries and developing transition countries has been growing rapidly. The rise was widespread, covering all three major groups nevertheless the reasons for the increase differed across the globe (see figure 2.1).\textsuperscript{221} There was a large increase in the share of developing countries and transition economies in FDI inflow as it surged by 320 per cent, reaching a record level of $777 billion, mainly through a continuing increase in Greenfield projects. In the same direction, FDI flows to developed countries also rose by 69 per cent, reaching the level of 748 however in these countries the growth was largely due to cross-border M&A’s by foreign MNCs.

\textsuperscript{221} Peter Nunnenkamp (2002), Foreign Direct Investment in Developing Countries: What Economists (Don’t) Know and What Policymakers Should (Not) Do!, Cuts Centre for International Trade, Economics & Environment, P 10.
Table 2.1: FDI Inflows by region and economy, In Millions of US$

<table>
<thead>
<tr>
<th>Region/economy</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>627,974.8</td>
<td>566,956.4</td>
<td>744,323.2</td>
<td>980,727.2</td>
<td>1,463,351.2</td>
<td>1,975,537.0</td>
<td>1,780,705.7</td>
<td>1,197,823.7</td>
<td>1,309,001.3</td>
<td>1,524,422.2</td>
</tr>
<tr>
<td>Developed economies</td>
<td>443,388.0</td>
<td>376,813.1</td>
<td>422,455.3</td>
<td>622,569.1</td>
<td>961,688.3</td>
<td>1,310,425.4</td>
<td>1,019,648.0</td>
<td>605,212.3</td>
<td>616,586.1</td>
<td>747,560.0</td>
</tr>
<tr>
<td>Developing economies</td>
<td>173,326.7</td>
<td>180,119.3</td>
<td>291,889.3</td>
<td>327,284.1</td>
<td>427,163.4</td>
<td>574,311.5</td>
<td>650,016.8</td>
<td>519,225.0</td>
<td>616,960.7</td>
<td>694,399.3</td>
</tr>
<tr>
<td>Africa</td>
<td>14,628.9</td>
<td>16,190.5</td>
<td>17,367.1</td>
<td>30,504.8</td>
<td>36,782.9</td>
<td>51,478.9</td>
<td>57,841.5</td>
<td>52,444.9</td>
<td>43,122.1</td>
<td>42,651.9</td>
</tr>
<tr>
<td>Asia</td>
<td>100,063.4</td>
<td>123,708.8</td>
<td>177,963.5</td>
<td>218,420.4</td>
<td>299,907.0</td>
<td>349,412.2</td>
<td>380,360.4</td>
<td>315,237.5</td>
<td>384,063.0</td>
<td>423,157.0</td>
</tr>
<tr>
<td>Bahrain</td>
<td>217.0</td>
<td>516.7</td>
<td>866.3</td>
<td>1,048.7</td>
<td>2,914.9</td>
<td>1,758.1</td>
<td>1,793.9</td>
<td>257.2</td>
<td>159.9</td>
<td>780.9</td>
</tr>
<tr>
<td>Kuwait</td>
<td>3.6</td>
<td>-67.1</td>
<td>23.8</td>
<td>233.9</td>
<td>121.3</td>
<td>111.5</td>
<td>-6.0</td>
<td>1,113.6</td>
<td>316.7</td>
<td>396.6</td>
</tr>
<tr>
<td>Lebanon</td>
<td>1,336.0</td>
<td>2,860.0</td>
<td>2,483.7</td>
<td>3,321.5</td>
<td>3,131.7</td>
<td>3,363.0</td>
<td>4,333.0</td>
<td>4,803.6</td>
<td>4,279.9</td>
<td>3,200.0</td>
</tr>
<tr>
<td>Oman</td>
<td>122.2</td>
<td>484.4</td>
<td>228.9</td>
<td>1,538.7</td>
<td>1,966.9</td>
<td>3,331.6</td>
<td>2,961.9</td>
<td>1,508.5</td>
<td>1,141.7</td>
<td>788.0</td>
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<td>Qatar</td>
<td>623.9</td>
<td>624.9</td>
<td>1,159.0</td>
<td>2,500.0</td>
<td>3,360.0</td>
<td>4,700.0</td>
<td>3,778.6</td>
<td>8,124.7</td>
<td>4,670.3</td>
<td>-86.8</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>453.0</td>
<td>778.5</td>
<td>1,942.0</td>
<td>12,097.0</td>
<td>17,140.0</td>
<td>22,821.1</td>
<td>38,151.0</td>
<td>32,100.0</td>
<td>26,105.0</td>
<td>16,400.0</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>95.3</td>
<td>4,256.0</td>
<td>10,003.5</td>
<td>10,003.9</td>
<td>10,800.0</td>
<td>12,800.0</td>
<td>14,166.5</td>
<td>13,723.6</td>
<td>4,002.7</td>
<td>5,500.0</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>58,490.8</td>
<td>47,073.9</td>
<td>79,968.7</td>
<td>89,903.8</td>
<td>98,175.4</td>
<td>172,280.9</td>
<td>209,517.0</td>
<td>149,422.4</td>
<td>187,400.7</td>
<td>216,988.3</td>
</tr>
<tr>
<td>Transition economies</td>
<td>11,260.1</td>
<td>20,023.9</td>
<td>30,284.1</td>
<td>30,854.0</td>
<td>54,318.4</td>
<td>90,800.1</td>
<td>121,040.9</td>
<td>72,368.4</td>
<td>73,765.4</td>
<td>92,162.9</td>
</tr>
</tbody>
</table>

Source: UNCTAD, FDI/TNC database (www.unctad.org/dfistatistics).

In summary, there were numerous challenges in the global market during 2011 in terms of natural disasters in Asia-Pacific, economic and political instability in Europe, North Africa and the Middle East, and the Arab Spring uprisings which led many MNCs to put on hold their FDI plans, leading to a sharp decline in FDI in many countries. Nevertheless, the number of FDI projects increased by 5.6% in 2011, faster than the 3% increase in 2010. In total, FDI Markets recorded 13,718 FDI projects in 2011. After declining by 14.5% in 2010, the estimated capital investment associated with FDI projects grew by 1.2% in 2011 to $860bn, indicating the beginning of a recovery in more capital-intensive sectors. Sector wise, renewable energy was the fastest growing sector of FDI in 2011; this sector became the leading sector for capital investment in Europe in 2011, and was the second largest sector in North America. The same pattern was seen in employment, with estimated direct job creation from FDI for example the decline in GCC was 35%
increasing by 2.5% in 2011 to 2.27 million, following a 3.5% decline in 2010. United States remains the top as a source as well as destination for FDI.

**Table 2.2: FDI Inward Stock by region and economy, In Millions of US$**

<table>
<thead>
<tr>
<th>Region/economy</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World</strong></td>
<td>7,501</td>
<td>9,387</td>
<td>11,100</td>
<td>11,583</td>
<td>14,300</td>
<td>17,301</td>
<td>15,451</td>
<td>18,041</td>
<td>19,906</td>
<td>20,436</td>
</tr>
<tr>
<td><strong>Developed economies</strong></td>
<td>5,654</td>
<td>7,233</td>
<td>8,577</td>
<td>8,577</td>
<td>10,550</td>
<td>12,738</td>
<td>10,812</td>
<td>12,396</td>
<td>12,980</td>
<td>13,055</td>
</tr>
<tr>
<td><strong>Europe</strong></td>
<td>3,130</td>
<td>4,139</td>
<td>5,085</td>
<td>4,991</td>
<td>6,372</td>
<td>8,030</td>
<td>7,262</td>
<td>8,001</td>
<td>8,082</td>
<td>8,081</td>
</tr>
<tr>
<td><strong>North America</strong></td>
<td>2,477</td>
<td>2,744</td>
<td>3,032</td>
<td>3,159</td>
<td>3,688</td>
<td>4,069</td>
<td>2,936</td>
<td>3,542</td>
<td>3,981</td>
<td>4,104</td>
</tr>
<tr>
<td><strong>Other developed countries</strong></td>
<td>276</td>
<td>370</td>
<td>459</td>
<td>426</td>
<td>509</td>
<td>638</td>
<td>614</td>
<td>752</td>
<td>1,032</td>
<td>1,032</td>
</tr>
<tr>
<td><strong>Developing economies</strong></td>
<td>1,730</td>
<td>1,979</td>
<td>2,325</td>
<td>2,712</td>
<td>3,555</td>
<td>4,487</td>
<td>4,214</td>
<td>5,120</td>
<td>6,256</td>
<td>6,625</td>
</tr>
<tr>
<td><strong>Africa</strong></td>
<td>166</td>
<td>201</td>
<td>238</td>
<td>260</td>
<td>314</td>
<td>392</td>
<td>391</td>
<td>488</td>
<td>561</td>
<td>569</td>
</tr>
<tr>
<td><strong>Asia</strong></td>
<td>1,032</td>
<td>1,177</td>
<td>1,367</td>
<td>1,624</td>
<td>2,079</td>
<td>2,691</td>
<td>2,965</td>
<td>3,112</td>
<td>3,716</td>
<td>3,990</td>
</tr>
<tr>
<td><strong>East and South-East Asia</strong></td>
<td>923</td>
<td>1,031</td>
<td>1,186</td>
<td>1,360</td>
<td>1,714</td>
<td>2,357</td>
<td>2,035</td>
<td>2,390</td>
<td>2,862</td>
<td>3,144</td>
</tr>
<tr>
<td><strong>West Asia</strong></td>
<td>65</td>
<td>91</td>
<td>117</td>
<td>188</td>
<td>254</td>
<td>373</td>
<td>375</td>
<td>405</td>
<td>587</td>
<td>575</td>
</tr>
<tr>
<td><strong>Bahrain</strong></td>
<td>6</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>11</td>
<td>12</td>
<td>14</td>
<td>14</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td><strong>Kuwait</strong></td>
<td>44</td>
<td>384</td>
<td>408</td>
<td>645</td>
<td>773</td>
<td>945</td>
<td>8,722</td>
<td>10,332</td>
<td>11,235</td>
<td>10,765</td>
</tr>
<tr>
<td><strong>Oman</strong></td>
<td>1,874</td>
<td>2,417</td>
<td>2,460</td>
<td>4,132</td>
<td>5,720</td>
<td>9,152</td>
<td>11,680</td>
<td>13,142</td>
<td>14,217</td>
<td>15,005</td>
</tr>
<tr>
<td><strong>Qatar</strong></td>
<td>2,031</td>
<td>3,456</td>
<td>4,655</td>
<td>7,155</td>
<td>10,655</td>
<td>15,355</td>
<td>17,769</td>
<td>25,694</td>
<td>30,564</td>
<td>30,477</td>
</tr>
<tr>
<td><strong>Saudi Arabia</strong></td>
<td>17,734</td>
<td>18,512</td>
<td>20,454</td>
<td>33,535</td>
<td>50,659</td>
<td>73,480</td>
<td>110,200</td>
<td>142,300</td>
<td>170,450</td>
<td>186,850</td>
</tr>
<tr>
<td><strong>United Arab Emirates</strong></td>
<td>2,348</td>
<td>6,064</td>
<td>16,608</td>
<td>27,508</td>
<td>40,314</td>
<td>54,500</td>
<td>68,224</td>
<td>72,227</td>
<td>77,777</td>
<td>85,406</td>
</tr>
<tr>
<td><strong>Latin America and the Caribbean</strong></td>
<td>529,011</td>
<td>597,276</td>
<td>714,091</td>
<td>823,436</td>
<td>954,621</td>
<td>1,195,999</td>
<td>1,227,969</td>
<td>1,506,452</td>
<td>1,963,581</td>
<td>2,048,101</td>
</tr>
<tr>
<td><strong>Transition economies</strong></td>
<td>115</td>
<td>154</td>
<td>197</td>
<td>272</td>
<td>394</td>
<td>675</td>
<td>424</td>
<td>624</td>
<td>759</td>
<td>757</td>
</tr>
</tbody>
</table>

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Looking towards an overall direction trend, FDI is directly motivated by resources. In recent years more economic factors are becoming important to MNCs in host economies, such as market size, cost of labour and material input. A clear example of one such move would be by the Japanese moving their industries to nearby Asian countries like China, Korea, and Malaysia etc. for the production and assembly of various electronics. During the start from 1980s to 1990s most of the FDI was targeted towards developed countries such as the United States, European Union

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223 For country like with oil based economy, mainly those related to the oil and gas industry

224 Japan started moving a lot of its industries such as steel, shipbuilding, electronics and car parts to nearby Asian countries, particularly South Korea to divert the excess to those markets and benefit from cheap labour force as well as their quota in international market.
countries and Japan due to their identical characteristics. In fact, the developed countries have been main FDI destinations because these countries offered a stable environment, low corruption, large markets, skilled workforce and high absorptive capacity. However, we also see an increase in investment in the developing countries, associated with large domestic markets, low costs of skilled and unskilled labour, and high returns on investments having a significant impact on the global economy, particularly in the economics of the industrialized states. Trends in world FDI flow depict that developing countries make their presence felt by receiving a considerable chunk of FDI inflows. As a result, the share of developing and transition countries in world FDI inflows for the first time in 2010 and continuing in 2011, attracted more than half of global FDI flows. UNCTAD indications suggest that developing and transition economies will continue to keep up with the pace of growth in global FDI in the medium term. Advanced factors explaining this increase in FDI flow into those countries include intense competitive pressures in many industries of the source countries, higher prices for many commodities, which stimulated FDI to countries that are rich in natural resources, and higher expectations for economic growth. UNCTAD identifies some of the most important factors leading to such a surge in global FDI flows. They include the increasing trend in privatization and the resulting foreign firms' acquisition of domestic firms, globalized production, and global financial integration.

In terms of the main source of FDI, historically, the high-income developed countries was mainly USA, Japan, UK, France and Germany together accounted for 90% of FDI to developing countries in 1995. The country of origin or source of FDI has an important influence on spillover between domestic firms and MNCs. This is due to

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225 In fact this is the main reason for increased interest in all the countries in improving their ranking made by rating agencies.

226 As those countries are still not saturated with investments and still not fully exploited and there is broad need for different types of commodities with no competition.

227 To understand the rationale behind FDI direction and why MNCs choose some countries and ignore others, why for example, Ireland and Singapore are masters of the art in attracting FDI while Nigeria and Venezuela are masters of repelling FDI, despite all their natural resources.

228 Most of the parent firms of the largest MNCs are based in the developed economies of the United States, Europe, and Japan.
the fact that FDI from developed countries such as the US, UK and Japan is characterized by ability in high technology. In this case if a spillover was to take place it is important for the host economy to have high absorptive capacity by having little technology gap and highly skilled human resources. While FDI from developing countries will be less complex in terms of technological capability while relying more on traditional factors such as the cost of capital, labour and input material. In fact, Findlay’s study (1978) is a pioneering contribution to this literature, while Lipsey and Sjöholm excel in their FDI spillover studies. Furthermore, Cohen and Levinthal, Glass and Saggi argue that firms need some minimum amount of absorptive capacity to be able to sail safe during spillovers. The United States has been the largest source country for directing their FDI mainly to Latin America and South Asia. Other important source countries include the United Kingdom, France, Germany, the Netherlands, and Japan. As might be expected most FDI flow has been to developing countries from developed countries the US, the EU & Japan, these countries also predominated since World War II, after which the U.S. has been the largest source country for FDI.

In review of the factors that can affect trends and patterns of FDI flow to different economies, we can further notice that these factors further consist of push (external) and pull (internal) factors. Push factors include economic conditions outside of the host economy such as international interest rate, limited size of home markets – hence the most appealing motive for FDI by developing countries. MNCs are market-seeking FDI challenged by the rising costs of production in the home economy – hence the

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233 This has been illustrated in the literature as discussed in section of chapter one.

234 Investment directed to neighbouring Asian countries

235 Home country driver
second most common motive for FDI is cost reduction FDI. This driver is also a factor underlying resources seeking FDI, although this motive is less common than market or cost reduction seeking FDI, as tense competition from both foreign and local firms in the home and foreign markets intensifies the impact of the above two drivers. In addition this driver may motivate firms to pursue “created asset seeking FDI”, to acquire technology and other expertise overseas in order to become more competitive. Pull factors, which are traditionally considered more important include conditions in the host country such as opportunities arising from liberalization, for instance easier access to foreign economies, better investment climates, and privatization programme, institutional development, input costs, domestic investment risk, rate of return, credit rating, bilateral trade agreement, domestic rate of growth, and stability (see figure 2.2).

Figure 2.2: Factors Impacting FDI trends

<table>
<thead>
<tr>
<th>Overall Policy Framework</th>
<th>Relating to Resource seeking FDI</th>
<th>Relating to Market seeking FDI</th>
<th>Relating to Efficiency seeking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic and political stability</td>
<td>Raw materials</td>
<td>Market size</td>
<td>Productivity</td>
</tr>
<tr>
<td>Rules regarding entry and operations of MNCs</td>
<td>Complementary factors of production (labour, capital and institution)</td>
<td>Market growth</td>
<td>Sufficient skilled labour</td>
</tr>
<tr>
<td>FDI incentives and privatisation policy</td>
<td>Sound infrastructure</td>
<td>Regional integration</td>
<td>Good technological base</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Trade policy</td>
</tr>
</tbody>
</table>

Source: adapted from different UNCTAD publications

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236 Efficiency seeking
237 Host country driver
2.1.1 Trend of Policy Change

Despite the mixed evidence, governments from all over the world have continued their efforts to liberalize their policies to attract FDI inflows. The potential of gaining from FDI particularly spillover effects persuade many countries to offer various incentives to attract FDI (UN, 1999). In fact, as pointed out in UNCTAD (2005a), of the 269 changes in FDI-related regulatory modifications reported in 2004, 87% of them were designed to increase the attractiveness of the countries. In 2011, this number was lower, but still 88% of the policy changes in that area were made to increase support to FDI. It appears that the liberalization of foreign investment policies could be related to the common perception that FDI has positive effects for the host economy.

Similarly, the 1990s witnessed an explosion in the number of national investment promotion agencies. Between 1990 & 2005, and then from 2005 to 2011, the number of such agencies increased from 11% to 63% net, where 3% to 20% increase was in developing countries. Many countries continued to liberalize and promote foreign investment in various industries to stimulate growth during the last decade. At the same time, new regulatory and restrictive measures continued to be introduced as some countries applied more complex FDI approach, where 100% foreign ownership is not allowed, sometimes with an exception for a particular area or sector. This could be due to political reasons and/or to insure the spillover from MNCS to the domestic economy (see table 2.3). Organizing investment and ensuring that it contributes to

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238 Whereas some authors find positive and significant productivity gains induced by the presence of foreign-owned enterprises, some others find insignificant or even negative effects in the hosting economy.


240 FDI is seen as an instrument for economic growth and technological enhancement, especially in developing and transition countries. Also, the generally accepted characteristics of multinational firms are being more productive than their domestic counterparts.

241 UNCTAD, (2012)

242 Investment policy measures undertaken in 2011 were generally favorable to foreign investors. Compared with 2010, the percentage of more restrictive policy measures showed a significant decrease, from approximately 32 per cent to 22 per cent.

243 Dunning (1977)

244 Harding and Javorcik (2007)

245 Regulatory measures affecting FDI included the adjustment of entry policies in some key sectors and more state control of extractive industries.
sustainable development is a priority for all countries. A new generation of investment policies is emerging, as governments pursue a broader and more intricate development policy agenda, while building or maintaining a generally favourable investment climate.

Table 2.3: Selected Country rankings by Inward FDI Attraction Index

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>113</td>
<td>100</td>
<td>46</td>
<td>34</td>
<td>19</td>
<td>22</td>
<td>23</td>
<td>55</td>
<td>111</td>
<td>147</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>1</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Ireland</td>
<td>2</td>
<td>1</td>
<td>5</td>
<td>182</td>
<td>182</td>
<td>181</td>
<td>151</td>
<td>31</td>
<td>13</td>
<td>5</td>
</tr>
<tr>
<td>Japan</td>
<td>106</td>
<td>110</td>
<td>115</td>
<td>120</td>
<td>144</td>
<td>121</td>
<td>116</td>
<td>117</td>
<td>117</td>
<td>132</td>
</tr>
<tr>
<td>Kuwait</td>
<td>179</td>
<td>179</td>
<td>180</td>
<td>161</td>
<td>164</td>
<td>166</td>
<td>172</td>
<td>164</td>
<td>159</td>
<td>160</td>
</tr>
<tr>
<td>Lebanon</td>
<td>23</td>
<td>14</td>
<td>11</td>
<td>7</td>
<td>9</td>
<td>11</td>
<td>10</td>
<td>9</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>29</td>
<td>19</td>
<td>109</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Oman</td>
<td>155</td>
<td>138</td>
<td>136</td>
<td>99</td>
<td>82</td>
<td>58</td>
<td>51</td>
<td>52</td>
<td>84</td>
<td>116</td>
</tr>
<tr>
<td>Qatar</td>
<td>106</td>
<td>96</td>
<td>72</td>
<td>41</td>
<td>41</td>
<td>48</td>
<td>62</td>
<td>33</td>
<td>34</td>
<td>47</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>141</td>
<td>138</td>
<td>131</td>
<td>67</td>
<td>42</td>
<td>35</td>
<td>18</td>
<td>6</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Singapore</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>144</td>
<td>95</td>
<td>25</td>
<td>11</td>
<td>11</td>
<td>26</td>
<td>29</td>
<td>41</td>
<td>62</td>
<td>87</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>16</td>
<td>45</td>
<td>48</td>
<td>15</td>
<td>8</td>
<td>7</td>
<td>12</td>
<td>14</td>
<td>24</td>
<td>29</td>
</tr>
</tbody>
</table>

Source: UNCTAD (www.unctad.org/fdistatistics).
Note: The Inward FDI Attraction Index ranking is based on the average of a country’s percentile rankings in FDI inflows and in FDI inflows as a share of GDP.

The overall policy trend towards investment liberalization and promotion appears more and more to be targeted at specific industries; in particular some services industries (see table 2.4). More State regulation became manifest primarily in two policy areas: an adjustment of entry policies by introducing new entry barriers or by reinforcing screening procedures to particular industries such as agriculture. Also, more regulatory policies in extractive industries, including nationalization, expropriation or divestment requirements as well as increases in corporate taxation rates, royalties and contract renegotiations. In both areas policy types were partly driven by industrial policy considerations. The trend towards continuous liberalization and promotion of

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246 UNCTAD (2012)
247 Electricity, gas and water supply; transport and communication
248 UNCTAD (2012)
investment often targeted specific industries.\textsuperscript{249} According to UNCTAD, the regulation in many countries concentrates in two main areas first adjusting entry policies with regard to inward FDI.\textsuperscript{250} Second, more government influence in extractive industries.\textsuperscript{251} However, there are considerable challenges that countries face in finding the suitable approach to FDI. These challenges may arise in making decisions in several areas such as how much to liberalize or restrict FDI\textsuperscript{252} and the right operational conditions to enforce on FDI.\textsuperscript{253}

**Table 2.4: Trends of National Policy Developments**

<table>
<thead>
<tr>
<th>Item</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numbers of Countries</td>
<td>43</td>
<td>59</td>
<td>80</td>
<td>77</td>
<td>74</td>
<td>49</td>
<td>41</td>
<td>45</td>
<td>57</td>
<td>44</td>
</tr>
<tr>
<td>Total changes</td>
<td>91</td>
<td>126</td>
<td>166</td>
<td>144</td>
<td>132</td>
<td>78</td>
<td>67</td>
<td>85</td>
<td>111</td>
<td>67</td>
</tr>
<tr>
<td>Liberalization/Promotion</td>
<td>79</td>
<td>114</td>
<td>144</td>
<td>119</td>
<td>107</td>
<td>59</td>
<td>51</td>
<td>61</td>
<td>75</td>
<td>52</td>
</tr>
<tr>
<td>Regulation/restriction</td>
<td>12</td>
<td>12</td>
<td>20</td>
<td>25</td>
<td>25</td>
<td>19</td>
<td>16</td>
<td>24</td>
<td>36</td>
<td>15</td>
</tr>
</tbody>
</table>

* Provisional

*Source: UNCTAD 2012 WR*

\textsuperscript{249} In 2011, 44 countries and economies adopted 67 policy measures affecting foreign investment. Of these measures, 52 related to investment liberalization, promotion and facilitation, while 15 introduced new restrictions or regulations for foreign investors.

\textsuperscript{250} Some countries modified their policy approach with regard to FDI by introducing new entry barriers (Latin America and Africa) or by reinforcing screening procedures (example India).

\textsuperscript{251} According to WIR 2012, some countries rich in natural resources took more regulatory approach to extractive industries. This due to several reasons include governments' desire to benefit from soaring global commodity prices and their wish to foster government control over natural resources, as well as their dissatisfaction with the performance of private operators. To obtain more control over extractive industries, governments have chosen different paths. These paths have led to nationalization, expropriation or divestment requirements. Some countries preferred to increase taxes and royalties in extractive industries.

\textsuperscript{252} Countries need to consider various alternatives of foreign ownership ceilings versus quantitative quota, formal restrictions versus more flexible screening procedures and mandatory requirements versus voluntary measures.

\textsuperscript{253} The level of openness to FDI may not be enough to deal with specific policy issue, as FDI requires a stable, predictable and enabling investment climate, solid support through a qualified workforce and good infrastructure and institutional set-up.
2.1.2 Sovereign Wealth Funds (SWFs)

New trend in terms of Sovereign Wealth Funds (SWFs) as new FDI investor. Although the history of the Sovereign Wealth Funds started from 1950s, it is only in recent years that they have appeared as important FDI players, particularly after the financial crises where a lot of mergers and acquisitions (M&As) took place mainly in developed economies. Despite sovereign wealth fund having assets of almost $5 trillion under management, FDI by sovereign wealth funds (SWFs) remains relatively small. However, SWFs seem well placed to invest in productive sectors in developing countries. They offer the scale to be able to invest in infrastructure development and the upgrading of agricultural productivity as well as in industrial development. To increase their investment in these areas, SWFs work in partnership with host-country governments and private sector investors that can bring technical and managerial competencies to projects. The growth of SWFs has been remarkable even during the recent global financial crisis. The total cumulative value of SWFs assets rose at an annual rate of 10 per cent, which growth is likely to continue as the emerging-market owners of most funds keep outperforming the world economy. However, the majority of SWFs investments are in the form of portfolio investors, with the bulk of their funds held in relatively liquid financial assets in mature market economies. Only a small proportion of their assets are in the form of FDI, estimated at $125 billion in 2011. FDI thus accounts for less than 5 per cent of SWFs assets and less than 1 per cent of global FDI stock in 2011. However, evidence shows a positive growth trend since 2005. FDI by

\[\text{254 The accumulation of official reserves far beyond established benchmarks of reserve adequacy has led an increasing number of countries to establish, or consider the establishment of, Sovereign Wealth Funds.}\]

\[\text{255 Mark Gordon, Wachtell, Lipton, Rosen & Katz Presentation to YPFP Sovereign Wealth and Investments in the Developed and Developing World, 24 June 2009.}\]

\[\text{256 Since quite little is known about most SWFs, market estimates of their size vary widely. Market estimates of aggregate assets of known SWFs range from $1.5 – 2.5 trillion.}\]


\[\text{258 There are a lot of political and legal considerations associate with this kind of investment.}\]
SWFs in developed countries has grown faster than that in developing countries, also reflecting the availability of acquisition opportunities particularly in North America and Europe during the crisis. However, SWFs FDI in developing countries is rising steadily. Furthermore, FDI by SWFs is concentrated on specific projects in a limited number of industries, finance, real estate, construction, and natural resources.

2.1.3 FDI and Gross Fixed Capital Formation

We can also look at FDI flows in terms of their share in gross fixed capital formation, which indicates the total amount of capital invested in factories, stores, office buildings, etc. This makes capital formation an important determinant of economic growth. Whilst domestic investments add to the capital stock in an economy, FDI plays a balancing role in overall capital formation and in filling the gap between domestic savings and investment. In addition, FDI a crucial determinant factor of increased future growth rate of an economy. In other words, FDI can be an important source of capital investment that can factor in the future growth rate of an economy.

Table 2.5: FDI Inflow as percentage of gross fixed capital formation, 2002-2011

<table>
<thead>
<tr>
<th>Region/economy</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>9.1</td>
<td>7.6</td>
<td>8.3</td>
<td>9.8</td>
<td>13.2</td>
<td>15.6</td>
<td>12.8</td>
<td>9.6</td>
<td>9.6</td>
<td>9.2</td>
</tr>
<tr>
<td>Developed economies</td>
<td>8.7</td>
<td>6.6</td>
<td>6.6</td>
<td>9.0</td>
<td>13.2</td>
<td>16.1</td>
<td>12.0</td>
<td>8.6</td>
<td>8.6</td>
<td>9.4</td>
</tr>
<tr>
<td>Developing economies</td>
<td>10.3</td>
<td>9.9</td>
<td>12.5</td>
<td>11.7</td>
<td>12.9</td>
<td>14.1</td>
<td>13.2</td>
<td>10.3</td>
<td>10.3</td>
<td>8.5</td>
</tr>
<tr>
<td>Africa</td>
<td>14.3</td>
<td>14.8</td>
<td>11.8</td>
<td>18.0</td>
<td>17.8</td>
<td>19.9</td>
<td>18.7</td>
<td>17.4</td>
<td>12.5</td>
<td>10.3</td>
</tr>
<tr>
<td>Asia</td>
<td>8.1</td>
<td>8.5</td>
<td>10.0</td>
<td>10.3</td>
<td>11.7</td>
<td>11.4</td>
<td>10.3</td>
<td>8.0</td>
<td>8.2</td>
<td>7.4</td>
</tr>
<tr>
<td>West Asia</td>
<td>3.6</td>
<td>8.7</td>
<td>11.3</td>
<td>18.6</td>
<td>23.4</td>
<td>20.1</td>
<td>20.3</td>
<td>16.4</td>
<td>12.6</td>
<td>9.1</td>
</tr>
<tr>
<td>Bahrain</td>
<td>13.6</td>
<td>26.6</td>
<td>31.8</td>
<td>33.8</td>
<td>71.2</td>
<td>36.0</td>
<td>24.7</td>
<td>5.0</td>
<td>2.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Kuwait</td>
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<td>18.4</td>
<td>16.2</td>
<td>15.4</td>
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</table>

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

259 Syed Abul Basher and Stefano Fachin, The Long-Run Relationship Between Savings and Investment in Oil-Exporting Developing Countries: A Case Study of the Gulf Arab States, Qatar Central Bank, 2011

260 UNCTAD (2012)
The share of global FDI inflows in the gross fixed capital formation account is 9.1% in 2002 and 9.2% in 2011 (see table 2.5). This shows how FDI inflows can have several consequences on the global economy. The MNCs role in production, trade and technology transmission in the domestic economy has increased many folds. The increasing presence of MNCs in the domestic economies of the developing countries has both direct and indirect effects. One key effect can be in the form of increased productive efficiency of domestic economic agents in production, also known in economic growth literature as spillovers - the center of this study. FDI continues to register notable growth as illustrated in figure 2. In 2002 global FDI stock was 22.4% of global GDP, while in 2011 global FDI stock was 28.7% of global GDP. Table 6 suggests that FDI has become increasingly important as a source of investment and production in the world’s economies.

Table 2.6: Inward stocks as a percentage of gross domestic products, 2002-2011

<table>
<thead>
<tr>
<th>Region/economy</th>
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<th>2003</th>
<th>2004</th>
<th>2005</th>
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<tr>
<td>Developing economies</td>
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<td>25.3</td>
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<td>26.5</td>
<td>29.8</td>
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<td>21.7</td>
<td>26.7</td>
<td>26.1</td>
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<tr>
<td>Latin America and the Caribbean</td>
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<td>32.1</td>
<td>30.5</td>
<td>30.0</td>
<td>31.9</td>
<td>28.1</td>
<td>37.2</td>
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<td>Transition economies</td>
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<td>36.9</td>
<td>18.1</td>
<td>34.9</td>
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<td>29.3</td>
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</tbody>
</table>

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Gachino, 2007
2.1.4 FDI by Sector and Industry

The change in overall FDI trend and pattern also reflects on major sectorial differences (see figure 2.6). Data on FDI projects indicate that the value and share of manufacturing has increase significantly, accounting for almost half of the total, while that of services sector dropped. Compared with the pre-crisis level (2005–2007) the picture is quite different. Now even though the primary sector seems to be recovering, services are still less than half, and manufacturing is 10 per cent below their pre-crisis levels. MNC investments from USA and Japan concentrate on petrochemicals, minerals, electronics, and transportation equipment, while MNCs from Germany and UK concentrate towards industrial development. The value of FDI projects in manufacturing rose by 23 per cent in 2010 compared to 2009, reaching $554 billion. The financial crisis hit a range of manufacturing industries hard, but the shock could eventually prove to be a boom to the sector, as many companies were forced to restructure into more productive and profitable activities with more attentive effects on FDI. In the United States, for example, FDI in manufacturing sector rose by 62% in 2010, accompanied by a substantial rise in productivity. Within manufacturing, business-cycle sensitive industries such as metal and metal products, electrical and electronic equipment and, wood and wood products were hit by the crisis in terms of sales and profits. As a result, investment fell in these industries, which suffered from serious overcapacity and wished to use cash to restore their balance sheet. In addition, their prospects for higher demand and market growth remained gloomy, especially in developed countries.

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262 UNCATAD 2012
There has been a shift towards FDI services since early 90s, as the sector composition of FDI has moved away from extractive and manufacturing industries and toward services. Hill in his book “Competing in the International Marketplace” suggested that there are four factors that drive the shift to services. Firstly, a lot of services cannot be traded globally. They must be produced in the countries where they are utilized. Secondly, a liberalization of policies governing FDI in services whilst; FDI remains more restricted in services, both developing and developed countries have taken some steps to open up their service industries. In fact, some developing nations could have liberalized their service industries beginning at a higher level of restrictiveness at an even speedier rate than developed nations over the past decade. While comprehensive data of FDI restriction in services does not exist, it is possible to deduce some values through subtraction from reservation lists in diverse international agreement, which deals with investment. Thirdly, the boom of Internet based global telecommunication networks has enabled some service ventures to reposition some of their value added activities to various countries to take advantage of favorable factor costs. Lastly, in many countries the shift reflects the common move away from

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264 Manafnezhad, (2005)

manufacturing and toward service industries. Services accounted for 52% of GDP in developing countries and 72% in developed countries by the early 2000s. As indicated above, FDI flows in the service industries are influenced by privatization trends. Many of the most significant recent privatization operations around the globe included the sales of telecommunication companies, public utilities and financial enterprises, which were open to participation by non-resident investors. Moreover, one interesting pattern we see with FDI is that firms in the same industry often make investments at about the same time, and tend to direct their investments toward certain locations.

2.1.5 FDI by modes of Entry

There is good literature material related to the FDI mode of entry and the degree of spillover our research focuses. For instance, the studies of Blomström and Sjöholm (1999) in Indonesia. Müller and Schnitzer (2006) and Javorcik’s (2004b) studies in Lithuania during 1996 to 2000. They all found that shared foreign and domestic ownership had positive spillover effect. In the same way, government restriction on the extent of foreign ownership in host economy policies is important. In some countries a more restrictive FDI approach applies. This could be applied to all sectors as is in Malaysia or in a particular sector, as is the case in GCC countries. Furthermore this could be broken down as a result of political reasons and/or to ensure a degree of spillover. Looking at the overall change in the FDI pattern we can differentiate between three main forms of FDI. First, is a greenfield investment, which involves establishing a wholly owned new operation in a foreign country. This form occurs mostly in developing nations and the main reason is a lack of suitable target firms and that it requires a longer time horizon for return on investment. It occurs through hire or purchase of local resources, constructing or buying buildings or building their own labour force. The second type of FDI is an acquisition or merger (M&As) with an existing domestic firm in the host country, through buying an existing company. This

266 The rise of Internet-based global telecommunications networks that have allowed some service enterprises to relocate some of their value added activities to different nations to take advantage of favourable factor costs.
form is easy to execute, can gain brand identification and goodwill, is a way to acquire knowledge, local financing could be possible and eliminates competitors.\textsuperscript{267} The third type is a joint venture (JV), which is a shared ownership in a foreign business. This is a viable strategy if the foreign investor finds the right local partner. JV has some advantages including that the local partner understands the market and can provide competent management at all levels. Also, some host countries require that foreign firms share ownership with a local partner; the local partner’s contacts and reputation enhance access to the host country’s capital markets; the local partner may possess technology that is appropriate for the local environment, the public image of a firm that is partially locally owned may improve its position. However JV has some drawbacks in terms of increased political risk if the wrong partner is chosen, local and foreign partners having divergent views on strategy and financing issues, transfer pricing creates potential for conflict of interests, financial disclosure between local partner and firm, ability of a firm to rationalize production on a worldwide basis, which may put local partner at disadvantage, and valuation of equity shares is difficult. The success of a joint venture depends primarily on the right partner. For this reason a number of issues relating to possible conflicts in decision-making exist.\textsuperscript{268}

According to the UNCTAD, the greater part of MNCs activities are in the form of acquisitions and mergers rather than greenfield investment, as firms prefer to acquire existing assets because mergers and acquisitions are quicker to execute than greenfield investments. It is easier and perhaps less risky for a firm to acquire desired assets than build new ones from the ground up. Firms believe they can increase the efficiency of an acquired unit by transferring capital, technology, or management skills.\textsuperscript{269} Greenfield investment and M&A have different impacts on host economies. In the short run, M&As clearly do not bring the same development benefits as Greenfield investment projects, in terms of the creation of new productive capacity, additional value

\textsuperscript{267} UNCTAD (2012)
\textsuperscript{268} UNCTAD (2009)
added and employment. The effect of M&A on, for example, host-country employment can even be negative, in cases of restructuring to achieve synergies. In special circumstances M&As can bring short-term benefits not dissimilar to greenfield investments; for example, where the alternative for acquired assets would be closure. Privatizations are another special case, where openness of the bidding process to foreign acquirers will enlarge the pool of bidders and increase the value of privatized assets to the State. In any case, over a longer period, M&As are often followed by sequential investments yielding benefits similar to greenfield investments. Also, in other investment impact areas, such as employment and technology dissemination, the differentiated impact of the two modes fades away over time. We can notice new trends in the mode of entry where in the 1980s and early 1990s MNCs preferred to have 100% ownership. Now, that concept has retired, leading the way to finding suitable and strong local partners in gaining access to local markets as well as government projects instead. In some cases even different MNCs from different countries of origin and/or sectors integrate with each other to serve the need for a particular market. Another new development in MNCs makes use of natural resources, such as minerals, oil and gas by forming a Build, Operate and Transfer (BOT) or product sharing agreement. There are diverging trends between the two main modes of FDI entry: M&As and greenfield investment. The value of cross-border M&A purchases deals increased by 85 per cent in 2011, to $525 billion, compared with $248 billion in 2002. These deals were largely in the services sector, accounting for 67%, manufacturing 26% and the primary sector 7%. In the same direction, the number of greenfield investment projects increased by 64 per cent to 15638 projects compared with $9533 billion in 2003. These projects were mainly in the manufacturing sector 7982, services 7487 and primary sector 169 projects. In terms of destinations developing and transition economies accounted for 53% and developed economies accounted for 47%. In terms of value, the value of greenfield projects increased from $801 billion in 2003 to $904 billion in 2011. The sources of these projects in 2011 were 71% from developed countries mainly Europe and United

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270 Despite many new emerging trends in MNC collaborations, M&As and Greenfield FDI remain important alternative modes of market entry for many companies.
States; developing and transition economies accounted for 29% of the total value of greenfield.

Compared with 2010, Cross-border M&As rose by 53 per cent in 2011 to $526 billion. Rising M&A activity, especially in the form of megadeals in both developed countries and transition economies, served as the major driver for this increase. The total number of megadeals increased from 44 in 2010 to 62 in 2011. The extractive industry was targeted by a number of important deals in both of those regions, while in developed countries a sharp rise took place in M&As in pharmaceuticals. M&A's in developing economies rose slightly in value. In contrast, greenfield investment projects remained flat in value terms, at $904 billion. Greenfield investment projects in developing and transition economies rose slightly in 2011, accounting for more than two thirds of the total value of such projects. Although the growth in global FDI flows in 2011 was driven in large part by cross-border M&As, the total project value of greenfield investments remains significantly higher than that of cross-border M&As, as has been the case since the financial crisis.

**Figure 2.4: Number of Cross-border M&A Sales by Sector**

![Bar chart showing number of cross-border M&A sales by sector.](image)

Source: UNCTAD, WIR 2012

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271 Those with a value over $3 billion
The forms of FDI inflow differ in varying circumstantial differences in the application of greenfield investments and merger and acquisition of existing firms. It is important to note that when a developing country is targeted by FDI inflows, mergers and acquisitions are much less common, probably because there are fewer firms to acquire or merge with in developing countries as compared to the developed countries. Several reasons encourage firms to make FDI investments in other countries and not just rely on export or to sign a licensing agreement with a foreign company. As exporting involves producing goods at home and then shipping to the receiving country for sale firms may run into trade barriers that make this strategy less attractive. A firm will favour FDI over exporting as an entry strategy when transportation costs and trade barriers are high. On the other hand, a firm will favour FDI over licensing when it wants better control over its technological know-how and over its operations and business strategy; also, if the firm’s capabilities are not amenable to licensing. It is common for firms in the same industry to have similar strategic behaviour and undertake foreign direct investment around the same time. Furthermore, licensing is not always a viable option for foreign expansion, as licensing involves granting a foreign entity the right to produce and sell the firm’s product in return for a royalty fee on every unit the foreign entity sells, and while it may seem like a good way to get into a foreign market without the costs and risks of FDI, like exporting, licensing isn’t always attractive to companies. Internalization theory suggests that licensing is not appropriate for three main reasons. First, licensing may result in a firm’s giving away valuable technological know-how to a potential foreign competitor. A second problem with licensing is that it does not give a firm the tight control over manufacturing, marketing, and strategy that may be required to be successful in a foreign market. Finally, if a firm’s competitive advantage is based on management, marketing, or manufacturing capabilities rather than its product, licensing is probably not attractive. Firms will prefer FDI to exporting or licensing when transportation or trade barriers make exports unattractive, and when it wants to maintain control over its technological know-how, over its operations and business strategy, or when its capabilities are simply not amenable to licensing.
2.2 GCC Countries: Patterns and Trends of FDI

2.2.1 Growth in GCC FDI inflow

The GCC, like other developing countries, seek greater inflows of FDI, not only in order to benefit directly from the capital inflows, but more importantly to use it as a strategic tool to overcome some of their internal challenges, particularly diversifying their economic base, creating jobs for young and growing populations and funding the future national development. The GCC governments have shown considerable interest in liberalizing their economies and attracting FDIs over the past years. In 1981 the GCC created a political and economic alliance and trade bloc, with the objective of integrating and coordinating in fields and formulating similar regulations in the economy, finance, trade, legislation and administration. In 1983 the GCC formed a free trade area. In 2002 a Customs Union was formed, with a unified external tariff ranging between 5% and 10% throughout the GCC. In 2008, the GCC launched a Common Market and are aiming for a monetary union. Several empirical studies have been conducted with the aim of discerning the impact of FDI on GCC economies. For example, Hussein (2009) used recent growth theories and statistical techniques, finding a weak relationship between FDI and GDP in the panel of the GCC. He concluded that GCC countries should be selective in attracting FDI because these countries have abundant financial resources and domestic investment could finance their development. That being said, FDI can potentially result in higher growth through higher efficiency in physical and human capital and enhancement of the productivity of domestic firms to drive the development.

Another study, by Sadik and Bolbol (2001), found that FDI has not had any manifest positive spillovers on technology and productivity over and above those of

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272 Despite increased diversification efforts, the region still relies on hydrocarbon industries. This makes the region vulnerable to energy price swings and geopolitical risks.
274 through productivity spillovers in form of such as facilitating transition and diffusing technology as well as introduction of alternative management practices, organizational arrangement, and improved entrepreneurial skills.
other types of capital formation.\textsuperscript{275} However, they found that there are some indications that the effect of FDI on total factor productivity has been lower than domestic investments in some of the countries over the period studied, indicating a possibly dominating negative crowding out effect.

As a result of strong economic prospects and improved policy and regulatory environment, the GCC countries have seen a marked increase in FDI inflows in recent years. The recent trend of the FDI flow and stock into GCC countries is summarized in figure 2.8. According to the World Investment Report 2013, the FDI inflow increased from a relatively modest $1 billion on average during 1990–2000 to $28 billion during 2001–2011, reaching a $61.7 billion in 2008, and targeting mainly services. Since then, because of many challenges in global markets, particularly political instability in the Middle East and the Arab Spring uprisings, many MNCs put their FDI plans on hold, leading to decline in FDI in many GCC countries in 2009, 2010 and 2011, reaching $29 billion in 2011. Looking at FDI stock data for 2011, the services sector accounted for 59% of inward FDI, manufacturing for 27% and the primary sector mainly the oil and gas upstream industry where restrictions on FDI participation remain for 14%. Services were also dominant in greenfield FDI projects, attracting 51 per cent of estimated investments during 2003–2011; 44 per cent targeted manufacturing and 5 per cent went to the primary sector. Among member countries, Saudi Arabia was the preferred destination for FDI inflows, followed by the UAE, while Kuwait was way down the list with a very small share. From an international perspective, FDI inflows into the GCC remain modest, accounting for 2% of total world inflows in 2011. This small share suggests that the GCC still has a long way to go in improving its relative attractiveness compared to other emerging markets. For example, a relatively small country like Hong Kong, with a (GDP) equivalent to 25% of the total GDP all GCC countries combined, attracted exceeded US$83 billion in FDI in 2011, far more than the GCC level.\textsuperscript{276}

\textsuperscript{276} According to the WIR (2012)
Figure 2.5: FDI (flow and stock) 2002-2011, US Dollars in millions

Table 2.7: Number of Greenfield FDI Projects by destination

<table>
<thead>
<tr>
<th></th>
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Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets.

Table 2.8 Number of cross-border M&As by economy of purchaser

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<tr>
<th>Region/economy</th>
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<td>15</td>
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<tr>
<td>Qatar</td>
<td>-</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>1</td>
<td>8</td>
<td>19</td>
<td>9</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>8</td>
<td>14</td>
<td>10</td>
<td>13</td>
<td>3</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>6</td>
<td>6</td>
<td>10</td>
<td>22</td>
<td>42</td>
<td>56</td>
<td>68</td>
<td>36</td>
<td>18</td>
<td>31</td>
</tr>
</tbody>
</table>

2.2.2 Emerging role of SWFs in regional FDI

The Sovereign Wealth Funds (SWFs) from GCC have become increasingly important as a global investor. Those countries hold about 40% of global oil reserve, while the region’s population represents less than 1 percent of the global total. This is due to several reasons such as limitations of investment in local real assets; making investment in foreign assets an attractive alternative. In addition, foreign investment, even when the actual return is small, may often be deemed superior to domestic capital formation because it prevents some of the incidental costs of instant inflation that arise from a rapid increase in domestic spending. To solve fiscal imbalance issues, Oman like others oil rich countries established stabilization funds, where some of oil revenues would be used during a short fall. Similarly some decided on saving part of the oil revenues for the future.

2.2.3 Policy changes and Reforms

Globalization has intensified the competition for FDI among developing countries. Thus concentrated efforts are needed at both national and regional level in order to attract significant FDI flows to the GCC countries and improve prospects for sustained growth and development. GCC countries have begun working together to design and formulate adequate policies to attract stable investment flows.

To promote economic growth and diversification, the governments of GCC countries have actively sought to attract FDI through new business environment policies which are aimed at boosting the attractiveness of their investment environments. These include investment incentives; streamlining and simplifying the legal and regulatory frameworks; a favourable tax regime; expediting the issuing of visas; creating a one-stop shop to reduce time needed to approve and register investments; marketing.

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available investment opportunities and eliminating or reducing minimum capital requirements. 279

Also, building economic zones and cities has generally consisted of providing advanced information and communications technology, infrastructure and services to attract leading companies, 280 especially those which are service-based. More than 55 such cities or zones have been established or are under way, generally targeting knowledge-intensive industries. One theory to explain these patterns is based on the idea that FDI flows reflect strategic rivalry between firms. 281 Knickerbocker explored the relationship between FDI and rivalry in oligopolistic industries, or industries that are composed of a limited number of large firms. 282 These industries are unique because what one company does can have an immediate effect on the others forcing them to take similar actions. 283 In addition, active industrial policies have targeted FDI in specific activities, using oil revenues to establish projects and encouraging foreign investors to participate for example, in petrochemicals and petroleum refining, and the building of economic zones and new cities. The soaring oil prices and increasing margins on refining in the 2000s encouraged Gulf countries to establish refinery/petrochemical complexes to produce products with higher added value. They also opened the door wider to international oil companies, as providers of technologies and market experience. In fact, all GCC countries have taken a step toward policies that are conducive to attracting FDI. For example, the United Arab Emirates (UAE) launched several new free trade zones intended to establish the UAE as a global centre for trade in gold bullion, research and development of technology, and financial activities.

279 Syed Abul Basher and Stefano Fachin(2011), The Long-Run Relationship Between Savings and Investment in Oil-Exporting Developing Countries: A Case Study of the Gulf Arab States, Qatar Central Bank


281 MNEs in general seek access to certain kinds of location-specific assets to exploit – large markets, cheap labour, skilled labour, cheap infrastructure


283 Take the airline industry for example. If one airline cuts prices on certain routes, other airlines quickly make similar changes.
Bahrain, permitted foreign ownership to increase from 49 to 100 percent of businesses in all but a few strategic sectors particularly, oil and aluminium. Kuwait, established a Foreign Investment Capital Office to process FDI applications and also, passed a law allowing foreigners to own 100 percent of Kuwaiti companies and reduced corporate taxes from 55 percent to 25%. Qatar reduced maximum corporate tax from 35 percent to 30 percent and allowed 100 percent foreign ownership in agriculture, industry, health, education, and tourism sectors, and streamlined investment approval procedures. Saudi Arabia established an associated investment authority to facilitate FDI processing, and cut the highest corporate income tax on foreign investment from 45 percent to 30 percent. They also permitted non-Saudis to own real estate for their business or residence, except in the two holy cities. Oman allowed 100 percent foreign ownership of companies in most sectors; allowed foreign, non-GCC, firms to own buildings and lease land. They opened up the service sector to full foreign ownership in line with WTO agreements. As the overall impact of FDI depends on human capital and a certain level of absorptive capacity of the host country in terms of level of technology of the host economy, educational level of the work force, level of infrastructure, financial and institutional development, etc. On the positive side, the GCC progressing toward making their economies more competitive at the global level through create transparent and clear legal systems to protect property rights, provide better governance, facilitate licensing and documentation, and eliminate hidden non-tariff barriers, liberalize the labour market, develop and liberalize financial markets and financial intermediaries and adopt and integrate a well-planned investment promotion strategy to attract an increased share of foreign investment, especially investments that will lead to exports and improving infrastructure (electricity, telecommunications and roads). On the downside, GCC countries still lag behind most countries in the Middle East in terms of privatization. Also, it is important to have clear policies that aim at channelling this FDI towards sectors that increase welfare and foster growth. Finally, national labour support laws in GCC countries may have also hindered FDI inflows into the region.

Creating clusters is one possible way of driving FDI to desired directions.
2.3 Oman and FDI

In the past twenty years, FDI exhibited a monumental expansion of inflows and outflows on a global level. Given the advantages attributed to the employment of foreign capital in the process of developing nations, such nations are inclined to liberalize their FDI policies for the maximization of FDI inflows.\textsuperscript{285} Oman, like many other developing countries, is interested in attracting FDI to enhance the overall development of the country and overcome local challenges to diversifying the economy and developing its private sector.\textsuperscript{286} Indeed, it is one of the many countries that suffer from a tendency to low savings leading to limited domestic investments. This situation calls for an increase in savings as well as an increase in investment rates, including foreign investment, to fill the saving-investment gap.\textsuperscript{287} In addition, FDI is expected to supplement local investment in utilizing its untapped resources, facilitate transfer of technology, know-how and managerial skills. The details of FDI in Oman are provided as follows.

2.3.1 Trend and Pattern of FDI in Oman

Despite an improvement in FDI inflow since 2002, and the great efforts made by the government to liberalize the economy, international reports show that FDI into Oman remains relatively modest and below expectations.\textsuperscript{288} In the GCC context, the pace of FDI inflows to Oman has been slower than KSA, Bahrain, UAE, and Qatar. This can also be confirmed by the decline in Oman’s relative share of FDI flow into the GCC from 8% in 2002 to 3% in 2011 and 5% in 2014.\textsuperscript{289} Moreover, Oman represented less than 0.02% of global FDI flows in both 2002 and 2011 and less than 0.01% in 2015 making the Sultanate a very small part of the global portfolio.\textsuperscript{290} In absolute terms, available statistics indicate that there is a significant growth in the volume of foreign investments

\textsuperscript{285} UNCTAD (2012)
\textsuperscript{286} Ahsan Mansur and Volker Treichel (1999), Oman Beyond the oil Horizon Policies Toward Sustainable Growth, International Monetary Fund, Washington DC, P 18
\textsuperscript{287} Ministry of National Economy (2010), Forty Glorious Years 1970-2010,
\textsuperscript{288} Published by the United Nations Conference on Trade and Development (UNCTAD), and the IMF, world Bank and international financial statistics (IFS).
\textsuperscript{289} According to UNCTAD FDI Database: KSA 52%, Bahrain 5%, UAE 28%, Kuwait 4% and Qatar 7%
\textsuperscript{290} World Investment Report, (2015)
in the Sultanate of around 12 times compared with 2002 level, reaching US$ 52353.8 million by the end of 2015 and amounting to 43% the of GDP at current prices.

**Figure 2.6: Total Foreign Investments in Oman by Type 2002-2015**

Source: National Centre for Statistics and Information, Foreign Investment Survey 2015

Compared with other forms of foreign investments, statistics for Oman indicate that FDI ranks second in terms of volume, reaching US$ 1873.9 million. This amounts to 33% of the total value of foreign investments in 2002 (see figure 2.8). Other investments (trade credit and loans) were the dominant forms of foreign investments, reaching US$ 2,532.7 million and amounting to 56.6% of the total value of foreign investments. Starting from 2013 FDI ranked first in terms of volume reaching US$ 19,860 million, i.e. 49.6% of the total value of foreign investments in 2014. FDI decreased by 12.5% in 2015 because of sharp decrease of the oil price and its negative

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291 Foreign investors prefer to finance their investments through borrowing from local financial institutions rather than injecting large amounts of new capital. This often guarantees foreign investor greater returns on the small amount of capital invested and also guarantees the return of loans.

292 Many FDI investors borrow money locally at favorable interest rates and thus finance their projects. This creates unfair competition with local firms and crowds the domestic private sector out of the credit markets, replacing its investments in the process.
impact on Omani economy, ranking second in terms of volume reaching US$ 17,370 million.\textsuperscript{293}

**Figure 2.7: Foreign Investment Types**

![Foreign Investment Types Chart]

*Source: National Centre for Statistics and Information, Foreign Investment Survey 2012*

There is a clear difference in the structure of foreign investments among the different economic sectors.\textsuperscript{294} For example, in the manufacturing sector, FDI represents only 30% of the total foreign investments; other investments and foreign portfolios investment represent the remaining 70%, while in the oil and gas sector, FDI accounts for more than half of the investments (51%), with other investments and foreign portfolios investment accounting for the remaining 49%. The manufacturing sector attracts more foreign investments in Oman as it accounted for 30% of the total foreign investments, or US$ 2,334.3 million in 2011, and US$ 3,353 million on average for the period. Most of the investments are concentrated in the manufacturing of basic chemicals or refined petroleum products. The financial sector has the second greatest proportion of foreign investments with US$ 2,006.3 million in 2011. Foreign investment in

\textsuperscript{293} Countries prefer FDI instead of other forms of foreign investment, due to the potential to benefit the host economy in a number of ways, including the provision of capital and transfer of know-how, skills and best practices, as well as provide Job opportunities.

\textsuperscript{294} This is in line with natural resource seeking; looking for resources at a lower cost, this includes oil and gas extraction, mining, and fisheries or lower labour costs for investing companies.
the oil and gas sector amounted to US$ 7139.5 million in 2011. Due to the increasing attention from the government to the tourism sector in Oman and real estate, rental and business activities accounted for 26% of the new foreign investments flow in 2011.

**Figure 2.8:** Foreign Direct Investment by industry 2015

As of 2015 FDI investors from 58 nations invested US$ 17370 million in Oman. More than half (53.7%) of these investments were from just two countries: the UK, and the UAE. 81% of all FDI stock in Oman in 2015 emanated from 9 countries.\(^{295}\) In addition to the two major source countries mentioned above, other important sources of FDI included Kuwait, USA, India, Qatar, The Netherlands, Bahrain, and Switzerland.

\(^{295}\) This sign calls for more diversification of source countries, as there are a positive relation between the number of source countries of FDI and productivity spillovers.
2.3.2 Profitability of foreign investment in Oman

Results of the Foreign Investment Survey (2016) indicate that the Sultanate is characterized by high returns on foreign investment. Payments of FDI income, including profits and proceeds from re-investment and interest paid to direct foreign investors, amounted to US$ 5625 million in 2014. This amount represents a profit rate of approximately 28.3 percent.\(^{296}\) In fact, the actual values would be much higher considering the transfer for international services provided by associated companies.\(^{297}\) This is a high rate compared to international standards, such as eight percent in the US, and ten percent in Japan.

This high rate of return also reflects the geographical advantages directly derived from Oman’s abundance of low cost foreign labour (easy access to labour from India, Pakistan and Bangladesh), expanding markets and abundant natural resources. It is

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\(^{296}\) This was calculated by using simple formula dividing income payment/FDI stock for the same year

\(^{297}\) National Centre for Statistics and Information, Foreign Investment Survey 2016.
sometimes argued that such high profits are justified by the higher risk and taxation levels confronted in Oman than elsewhere. However, the figures reported here are net income figures, so Oman’s taxation has already been taken into account. Moreover, comparisons on the variability of profits would suggest that concerns regarding the risk factor are overplayed. All this seems to imply that foreign investors have significantly underestimated the opportunities for profitable business enterprises in Oman.

Table 2.9: Income Payments by FDI Enterprises 2014

<table>
<thead>
<tr>
<th>Type of Payment</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>278</td>
<td>306</td>
<td>349</td>
<td>516</td>
<td>648</td>
<td>542</td>
<td>861</td>
<td>672</td>
<td>852</td>
<td>1,170</td>
<td>1,248</td>
<td>1,187.2</td>
<td>1,160.8</td>
</tr>
<tr>
<td>Reinvested earnings</td>
<td>32</td>
<td>60</td>
<td>(29)</td>
<td>78</td>
<td>98</td>
<td>309</td>
<td>429</td>
<td>179</td>
<td>574</td>
<td>492</td>
<td>509</td>
<td>532.5</td>
<td>940.2</td>
</tr>
<tr>
<td>Interest</td>
<td>3</td>
<td>4</td>
<td>1</td>
<td>4</td>
<td>15</td>
<td>12</td>
<td>24</td>
<td>25</td>
<td>11</td>
<td>27</td>
<td>19</td>
<td>20.2</td>
<td>62.0</td>
</tr>
<tr>
<td>Total</td>
<td>312</td>
<td>369</td>
<td>321</td>
<td>599</td>
<td>762</td>
<td>864</td>
<td>1,314</td>
<td>877</td>
<td>1,437</td>
<td>1,689</td>
<td>1,777</td>
<td>1,740</td>
<td>2,163</td>
</tr>
</tbody>
</table>


This is a high rate of profit compared to international standards and is due to a number of reasons:

- Oman’s economy is still not saturated with investments;

- The Omani market is still not fully exploited and there is a broad need for different types of commodities with no competition;

- Foreign investment in Oman is in the form of other investment (loans), and the paid-up capital is relatively small.298

- Investment in electricity, communication, oil and gas sectors are under special arrangement (cost protection sharing agreement).

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298 Foreign investors prefer to finance their investments through borrowing from financial institutions rather than injecting large amounts of new capital. This often guarantees foreign investor greater returns on the small amount of capital invested and also guarantees the return of loans.
2.3.3 Impact of FDI inflow on Omani Economy

FDI has a great potential to support the Omani economy, particularly private sector and subsequently add value to long-term development and economic diversification. Also, FDI can create employment for Omani nationals enhance the investment and exports. However, these outcomes don’t happen naturally.299

2.3.3.1 FDI’s Contribution to Value Addition in the Economy

According to a report by Ministry of National Economy based on 2003 data, most FDI investment was in the oil and gas sector, followed by the manufacturing sector, and the financial intermediation sector. Whilst the FDI enterprises in 2003 were only 0.4% of the total number of enterprises, in Oman they contributed 45% of gross value added in the economy in the same year.300 This is an indicator of how concentrated the economy of Oman was, with 0.4% of the enterprises producing 45% of value added in 2003. However, the situation is even more concentrated than these striking figures suggest

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300 Value addition is the System of National accounts 1993 concept referring to enterprise output minus the inputs used to produce the output by all resident producers inside the Sultanate of Oman. This concept measures economic activity by taking the total output from production in the country and subtracting the raw materials, goods and services consumed during the production process.
because the majority of the FDI that enterprises contribute to value addition comes from just two enterprises: Petroleum Development Oman (PDO) and Oman Liquefied Natural Gas (OLNG). These two businesses make up 85% of the value addition generated by all FDI enterprises in Oman. PDO contributed 34% and OLNG 4% respectively to total value addition in the economy. Putting these two enterprises aside, the contribution of the other 223 FDI enterprises to total value addition in the economy was 7% in 2003. Even amongst these 223 FDI enterprises, there was significant concentration, with about 50% of the contribution to total value coming from just 11 enterprises.\textsuperscript{301} In summary, the extent of concentration amongst FDI enterprises of the contribution of FDI is such that 13 FDI enterprises comprise 92% of all FDI enterprises’ contribution to value addition, and 42% of total value addition in the whole economy. The oil and gas sector contributes a large share of value addition compared to other sectors. The manufacturing (other than OLNG and oil refining), mining, quarrying and insurance sectors have medium levels of FDI at between 11% and 15% of total value added in each sector. According to the same report, there is a weak positive relationship between the contribution of FDI to total value addition in each sector of the economy and the relative size of the sector. Sectors like oil and gas extraction, manufacture of basic chemicals (OLNG), banking and construction are both large in terms of their relative share of the economy and the contribution of FDI to gross value addition in those sectors. Equally, sectors like health, agriculture, fishing, hotels and restaurants and oil refining are small in terms of relative share and have very little or no FDI contribution to value added.

2.3.3.2 FDI’s Contribution to Economic Diversification

Whether FDI has contributed towards economic diversification away from oil would be best answered by comparing the added value generated by FDI enterprises in the oil and non-oil sectors. The FDI in the oil sector\textsuperscript{302} contributed 36% of total value added in the economy whilst the FDI in non-oil sectors contributed 9% of total value added. This

\textsuperscript{301} The 11 enterprises were, in order of contribution: Bank Muscat, Oxy Oman, Halliburton Worldwide Ltd, Chiyoda-Foster Wheeler and Company, Daleel Petroleum LLC, Oman Arab Bank SAOG, Salalah Port Services Company SAOG, HSBC, CCC United Power Company SAOG and Dawell Schlumberger (Western) SA.

\textsuperscript{302} 5 in oil and gas extraction and 14 in services to the oil industry such as drilling
reflects the predominance of the oil sector amongst FDI. Another perspective is given by looking at the share of oil and non-oil sectors of total value added by FDI. 80% of the value added to the economy by FDI in 2003 was in the oil sector with the remaining 20% coming from the non-oil sector. Yet 48% of FDI stock in 2003 and 41% in 2015 was in the oil and gas sector. This shows that the majority of the economic impact of FDI has been in the oil sector and that FDI has gone into sectors where the greatest value additions could be made. To conclude, FDI has not yet contributed significantly towards economic diversification away from oil. Rather, it has helped Oman to exploit her oil resources and generate high value addition for the economy from this sector.

2.3.3.3 FDI’s Contribution to Export Performance

In general, Oman’s exports are dominated by the exports of oil and gas sectors, which are in turn dominated by the exports of PDO and OLNG respectively. In 2003, PDO contributed 70% of the Sultanate’s exports and OLNG 13%. Given that both these companies are FDI enterprises, the total contribution of FDI enterprises to Omani commodity exports (excluding re-export of imported goods – in Oman mostly vehicles) was large at 88% in 2003. The non PDO/OLNG contribution of FDI enterprises to total commodity exports was small at 5%. Some of this includes oil sector exports from FDI enterprises such as Oxy Oman, Novus Oman Limited and Daleel Petroleum. The 5% contribution of FDI enterprises other than PDO and OLNG was smaller than the contribution of non FDI enterprises. It was also smaller than their 7% contribution to total value addition in the economy, suggesting that their contribution towards exports is not significant. Apart from PDO and OLNG, FDI enterprises are not highly export-oriented. If they were as we would expect their share to be equal or greater than their current 7% share of total value addition. The relatively small contribution of FDI enterprises other than PDO and OLNG to total commodity exports is more clearly seen through an analysis of non-oil exports where FDI enterprises only contributed 19%, with the majority (81%) coming from non FDI enterprises. With regard to the distribution across sectors, Oman’s commodity exports come primarily from oil and gas extraction and manufacturing. About 1% of all commodity exports come from other sectors like trade and construction. Therefore the sectoral analysis of Oman’s commodity exports focuses on the extraction and manufacturing sectors. FDI were present in Oman’s top
two export sectors – oil and gas extraction and LNG – and were responsible for 94% to 95% of the export revenues generated in these sectors in 2003. Amongst the next eight largest export sectors, which together with oil and gas extraction and LNG account for 99% of all Omani commodity exports, FDI enterprises do not make a significant contribution. In the manufacturing of food and beverages and refined petroleum, the third and fourth largest export sectors, FDI enterprises are absent. In the manufacture of basic metals and other non-metallic mineral products they contributed 25% of export commodity value in 2003. In the manufacture of wearing apparel (clothing) and rubber and plastic products they contributed 10% and 17% of commodity exports in those sectors respectively. In the minor manufacturing sub sectors which accounted for very small proportions of total commodity exports in 2003, FDI enterprises hardly made any contribution at all. To conclude, FDI has contributed significantly towards exports mainly in hydrocarbon while making relatively small contribution to other exports than hydrocarbon.

2.3.3.4 FDI’s Contribution to Employment

Generating employment for Omani nationals is a major policy objective of the Omani Government, as well as diversification of the economy away from oil dependence. In 2012, according to data from the National Centre for Statistics and Information, (Economic Review 2014) FDI enterprises accounted for 15% of all private sector employment. They employed 48% of all Omani nationals and 13% of all expatriates. In the manufacturing sector, FDI enterprises accounted for 29% of total employment in that sector. The fact that, on average, FDI enterprises employ more Omani nationals than do non FDI enterprises appears a very positive finding but is a result of the fact that FDI enterprises are larger than non FDI enterprises.
According to a report by the Ministry of National Economy, the contribution of FDI enterprises to total employment of Omani nationals in 2003 was calculated taking the data on employment for the 2003 FDI Survey and dividing them by the total number of Omanis in employment from the 2003 Census. FDI enterprises employed 5.8% of all those employed in the economy in 2003. They employed 5.6% of all Omani nationals and 6% of all expatriates employed in the economy. Thus there is no significant difference between the proportion of Omani nationals and expatriates who are employed in FDI enterprises. There is considerable variation in the proportion of Omani nationals employed in FDI enterprises according to sector, ranging from 66% in the professional, personal and community services sector; 53% in the oil sector and zero in the education sector. In terms of the contribution of FDI to the generation of jobs, the evidence shows FDI enterprises generating more jobs for Omani nationals over time. At the same time comparing it with the generation of jobs for Omani nationals by non FDI enterprises, according to the same report, on average, FDI enterprises employ more staff than non FDI enterprises. In 2005 for example, the average FDI enterprise employed 129 Omani nationals whilst the average non FDI enterprise employed about 14 Omani nationals. This pattern is repeated in the manufacturing, hotel and restaurant, transport and communication, real estate and business sectors. The opposite pattern, whereby non FDI enterprises employ more Omani nationals on average than FDI enterprises is found in the oil servicing, banking and insurance sectors. Over the period 2000 to 2005 the average FDI enterprise has employed more Omanis over time with an
80% increase from 72 Omanis per enterprise in 2000 to 129 in 2005, whereas the average non FDI enterprise has employed fewer Omanis over time with a decrease from about 16 Omanis per enterprise in 2000 to about 15 in 2005. This shows that FDI enterprises have created a growing number of job opportunities for Oman nationals.

To conclude, it can be seen from the above analysis that FDI has had a major impact on the economy of Oman, generating 45% of the economic value added and 88% of exports. There has been some evidence for employment generation for Omani nationals over time. There are also some signs that FDI has led to some innovative business practices. At the same time, FDI has not contributed strongly to two of the Sultanate’s major policy goals: economic diversification and employment generation for Omani nationals. The contribution of FDI to the economy has been heavily biased towards the oil sector, with FDI playing a minority role and making a minority contribution to economic growth, export and employment generation in the non-oil sector. In this way FDI has not contributed towards economic diversification away from oil dependence but rather has helped Oman to exploit her oil resources and generate high value addition for the economy from this sector. The same report has highlighted the economic sectors with little FDI contribution and the source countries, either with lots of FDI stock globally, or a special interest in Oman, which represents a large proportion of their global FDI portfolio. Those organizations with responsibility for promoting inward investment will be able to plan which countries and which sectors to target. There is much scope for increasing the amount of FDI to Oman in a way that will contribute towards economic diversification. Second, FDI has gone into those economic sectors which employ only a minority of Omani nationals. If FDI is to make a strong contribution to employment generation for Omani nationals it needs to enter the sectors such as trade, transport, storage and communication; real estate, health, fisheries, agriculture and education where the majority of private-sector Omani employees work.

Monitoring the impact of FDI on the economy of Oman provides information with which government can manage the source countries and sectors from which FDI comes and the sectors it enters, so that major policy objectives of economic diversification and
employment generation are achieved. The movement of FDI changes rapidly from one year to another so that the situation in Oman and in the world needs close monitoring.

2.3.4 Investment Environment in Oman

By way of productivity spillover, FDI has played a key role in inducing private sector-led growth around the world.\textsuperscript{303} As indicated by UNCTAD (World Investment Report 2012), many countries have opted to create an attractive investment environment and continued their efforts to liberalize their policies around FDI to be able to benefit from expanding FDI. This has played an important role in helping many nations grow and take advantage of FDI investments as advanced technologies and good governance are important factors to open new markets and attract foreign capital. However, these benefits must not be taken for granted as they depend on the local business environment policies and the manner in which FDI is managed.\textsuperscript{304} A number of studies have indicated that the positive impact of FDI on growth depends on local conditions and absorption capacity.\textsuperscript{305}

Oman like many other countries, is putting efforts into creating an investment climate capable of enhancing the overall development of the country. For Oman to attract FDI and utilize it to enhance productivity spillovers, it needs to provide what foreign investors are looking for. This can be categorized into two categories. The first includes business needs in terms of economics of scale, cheap input (labour, materials, energy), connectivity within the country and with rest of the world, and real windows of opportunity with a good rate of return. Second includes the political risk that matter most for the activities of MNCs and have close association with FDI flows. This concerns government stability, internal and external conflicts, corruption, accountability and transparency within the system. It follows that the Omani policy makers should make a rule of law which would protect the foreign investment and strive to pursue a policy that will guarantee a stable political system.

\textsuperscript{303} Joseph E. Stiglitz (2002), Globalization and Its Discontents; Allen lane, the penguin press


Governments all over the world have opted to create an attractive investment environment, and improve their ranking in reports published by credit rating agencies and major international institutions. These reports take into consideration the different stages of economic growth and stages of development of countries and different indicators related to quality of infrastructure, the institutional framework, the extent of macro-economic stability, quality of health care and education, as well as incentives to efficiency associated with quality of higher education, training, market size, and the development of the financial market and technological readiness, as well as the progress in research and development (R & D). The approach presented in these reports is a useful tool to benchmark countries along several business indicators and identifies areas where relevant reforms are needed.

However, this approach is not sufficient for countries like Oman where the reform agenda of the business environment needs to be wide-ranging. This is due to several reasons. First, the Doing Business report treats all indicators as if they were equally important to all sectors or types of investments. Secondly, it does not look into the reasons behind the low performance of a country on a given indicator. Thirdly, it does not capture many relevant dimensions of the business environment in rentier countries. Fourthly, the Doing Business indicators do not take into account major institutional factors, such as political stability, social tension, and rule of law. Finally, Doing Business rankings are relative rather than absolute. A country will only move up the ranking if it improves its business environment more than other countries. Similarly, a country can keep its rank or even improve it if without taking any action if other countries decline in terms of certain business regulatory aspects.\[306\]

According to Omani’s National Centre for Statistics and Information issue number (3) released in December 2015, Oman had a mixed performance ranking in reports published by credit rating agencies and major international institutions. As shown in Appendix 2, the Doing Business Report, issued by the IFC and the World Bank, ranked Oman 70th of 189 economies in 2016 shown an improve compared to 57\[306\]th (from 183

economies) in 2010. The World Competitiveness Report (IMD) found that the Omani economy made significant progress in competitiveness, jumping from rank 31 in 2004 to rank 15 in 2009, due to the improved economic performance from No. 29 to No. 19 due to the improved ability of the Sultanate to create the conditions necessary to create a competitive economy and attract FDI. In the area of finance, according to Moody’s (2016) credit rating, Oman was downgraded to category (A3), compared with (A1) in 2010. This is due to the decline of the oil price and the limited financial flexibility of the government. It is also due to a slowdown of economic performance, and struggle of public finances as a result of decline in total reserves which accumulated in recent years.

With regard to the overall Omani business environment, the report of the Global World Economic Forum ranked Oman 62nd in 2015 compared to 34th in 2010, and 46th in 2014 indicating an apparent decline in the Oman’s business environment, which is likely to reduce foreign investor confidence. The report of the Global World Economic Forum emphasizes institutional structure, policies and factors that drive productivity, which in turn determine the level of prosperity which the economy can achieve. In the area of economic freedom, the Economic Freedom report issued by Fraser Institute in Canada, in 2012, ranked Oman 45th of 152 countries around the world. In this report, freedom is measured by the extent to which economic activities can function without government interference. Also, the report of economic freedom issued by the Heritage Foundation and Wall Street in 2015 ranked Oman 56rd of 178 economies. In the area of transparency, the report issued by Global Transparency organization, where the No. 1 ranking refers to the least corrupt, it was found that Oman reduced its ranking by 20 places to 64st of 174 countries. This is due to weak institutions and slow progress in reducing corrupt practices. Corruption is defined in the report as the abuse of public office in the public sector for personal gain. In the area of stability, the report of the

307 The rankings measure how well countries manage their economic and human resources to increase their prosperity.
308 The report is based on (12) indicators of competitiveness assembled in three groups of sub-indicators.
309 Economic freedom measures the freedom of choice, free trade, free competition and ensure the protection of private property.
310 The report draws on 13 surveys conducted by global institutions such as the Economist, the World Economic Forum and the International Institute for Management Development World Competitiveness, Centre and Freedom House.
States most stable ranked Oman 135th of 178 countries. This report is based on 12 indicators: social, economic, political and military. They include the economic situation, public services and population density, migration and equality in education and employment opportunities, human rights and the size of foreign interference, and others.

Another important aspect that affects the business environment is International Investment Agreements. According to economic theory, these agreements not only increase trade but also attract more FDI flows by creating a more integrated marketplace where MNCs enjoy low transaction cost and can exploit economies of scale.311 In the case of Oman, the main target is to benefit the private sector through encouraging foreign capital, which is usually accompanied with skilled labour, technology and access to foreign markets. New agreements have been formed to facilitate access to new technologies, building partnerships with other countries in entering new markets and lowering their costs of production. However, in order to benefit fully from these agreements, the Omani private sector needs to be better prepared. As illustrated in Figure 2.12, Oman has many multilateral and bilateral agreements such as the WTO and the Free Trade agreement with the United States of America preventing double taxation and this has added many benefits that strengthen the economic position of the Sultanate and provide vast opportunities for the development of the private sector. According to numerous economic studies, reports from the IMF and the World Bank, the purpose of adhering to such agreements is to encourage and facilitate the flow of capital, goods and services, and technology between countries. On the other hand such agreements do not just increase the availability of imported goods and services at more affordable rates, but also negatively affect the balance of payments and deplete foreign reserves.312

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311 Dunning, (1981)
2.3.5 Key policies to enhancing FDI Spillovers:
This section focuses on key FDI strategies, and policies, currently in practice in promoting productivity spillovers from MNCs to domestic companies. This will be reflected in policy to enable policymakers to make the adjustment needed to enable Oman to maximize the benefits and minimize the negative impacts of FDI, mainly in the policy related to free zones and local content initiative.
2.3.5.1 Clusters and Free zones:

Free Zones play an important role in stimulating economic activity in countries that establish them. A lot of countries including UAE and Malaysia use free zones to attract a massive volume of FDI and put appropriate policies in place to ensure spillovers from MNCs to domestic firms.\textsuperscript{313} According to available statistics in 2007 the effectiveness of such zones in enhancing the performance of the global economy, was reflected in the steady increase of free zones to more than 8,000 in more than 150 countries, with a value of trade (total exports and imports) exceeding 600 billion U.S. dollars, providing more than 50 million jobs.\textsuperscript{314} The free zones serve as an effective tool for economic development, supported by the comparative advantages of the national economy, and a business environment that is suitable for attracting local and foreign investment. Free zones provide a package of benefits including tax and customs exemptions and facilitate the training of skilled foreign workers alongside domestic labour, low management fees, land prices, electricity services and water and telecommunications. The importance of the free zones comes in the context of shifts in the Omani economy at the local, regional and global levels. There are many factors that drive Oman to take advantage of this tool to help achieve the objectives of sustainable development and enhance productivity spillover from MNCs. Chief amongst these are:

- Political and financial stability supported by the availability of infrastructure of institutions, facilities and services, roads, ports and the presence of appropriate legislative frameworks.

- Geographical location as a natural hub for the regional trade and international point of convergence between the markets of production and consumer markets.

- Joining a number of international and regional conventions such as the WTO and free trade agreement with the United States of America, and agreements preventing double taxation and the other, as the number of

\textsuperscript{313} World Bank (2008), Special Economic Zones, Performance, Lessons Learned and implications for Zone Development. By the Multi-Donor Investment Climate Advisory Services of the World Bank.

\textsuperscript{314} Jamil Tahir (1998), An assessment of Free Economic Zones in Arab Countries: Performance and main Features, paper was presented in an international conference on New Economic Developments and their impact on Arab Economies.
agreements signed with various countries of the world more than 45 agreements at the end of 2012

- The classification of advanced and international credit rating agencies, which would support the investment environment and reflects positively on the performance of free zones.

It is worth mentioning that the free zones contribute to achieving the goals set out in the successive Five-Year Plans through creating jobs, attracting foreign capital and the mobilization of domestic savings to create economically feasible projects as well as attract technology, technical skills and modern techniques. In addition, they stimulate logistics services for ports, roads and storage, create forward and backward linkages between productive projects in the free zones and also with their counterparts in other sectors of the national economy. They activate the role of local private sector through the establishment of projects in free zones or the provision of raw materials as inputs for the production of free zones and achieve the goal of balanced regional development.\textsuperscript{315}

\subsection*{2.3.5.2 Local content initiative}

Local content initiative can be a very useful tool to enhance spillovers from MNCs to local firms.\textsuperscript{316} The government and the oil and gas industry launched initiatives in 2012 aimed at developing ICV, with successful results. Those initiatives tackle several areas, such as workforce development, increase of local sourcing of goods and services and the enhancement of the business environment to support local businesses and FDI. In-country value is the total spends retained in the country that benefits business development contributes to human capability development and stimulates productivity in Oman’s economy. The key elements in ICV are local employment, local sourcing & local investment. This initiative is good for both local economy and business. This is because a lot of money is spent outside Oman through importation of goods and services. Spending money locally has a direct impact through job creation for Omanis and it creates the ‘multiplier’ effect in other parts of the economy.

\textsuperscript{315} Oman Vision 2020

\textsuperscript{316} Ministry of Oil and Gas, ICV document, Oman, 2014
For businesses, shorter supply chains and lower costs in the long run are benefits. ³¹⁷

### 2.3.5.3 Business Linkages Programme

This programme normally aims to support services to upgrade technology and skills of domestic companies by linking them with MNCs. This necessitates improving the capabilities of potential local suppliers and information flows between potential buyers and sellers. Such programme can be useful in developing the domestic firms, as these firms operate in isolation, and locked into uncompetitive production patterns and are unable to approach dynamic business partners that could bring in new expertise and know-how. This programme enhances domestic firms’ productivity through the realization of economies of scale and scope and is a source of sustainability.³¹⁸ Linkages help to achieve an inclusive development where domestic firms, particularly SMEs, participate in economic activities on fair terms.³¹⁹ However, this depends on the domestic firms readiness and capability.

### 2.3.5.4 State Owned Enterprises and Institutions

Many objectives underly the creation of State Owned Enterprises, including traditional ones, related to the fiscal budget and more importantly sectoral diversification, bringing new technology, innovation, providing information and helping SMEs and infant industry. A variety of institutions are needed to ensure the achievement of private sector led growth. These institutions balance and protect the rights of all concerned government parties, private sector firms and society. The main aim of establishing these institutions are to improve the policy environment in which the private sector operates hence encouraging linkages among local firms and particularly MNCs. This would facilitate the transition towards well-functioning markets with competitive and innovative businesses increasing productivity and incomes. In areas where environmental and social conditions are unsatisfactory, a strong institutional system will be a great asset. According to the Bertelsmann Transformation Index (BTI), created by the

³¹⁷ Ministry of Oil and Gas, ICV document, 2014


German think tank of the same name analysing political and economic transformation, all GCC states have a BTI index ranging from “limited” to “very limited”. Factors weighing heavily on these slow rates of transformation include corruption and lack of transparency. Indeed, the role of regulatory institutions to ensure proper functioning of private markets is critical, particularly in dealing with protection factor barriers currently in place in labour market and financial sector. All institutions and stakeholders must work closely with each other. In addition, to ensure the building of a strong private sector and accelerate the pace of economic diversification.
Chapter 3
Oman Political and Economic Environment

This chapter evaluates the prospects for FDI in Oman by analyzing the political and economic factors that shape the country’s business environment. These factors help explain why, despite the rise in prominence of many Gulf countries, including Oman, these countries still cannot manage “to attract more than 3% of FDI worldwide.” Hence, Oman has been subdued in its development and investment, and thus the country is less prominent on the radar of multinational companies, as well as those looking to grow to such a level. This is why Oman is struggling to get out of the rentier model and remains underdeveloped, despite recognizing the importance of economic liberalization.

When firms go through the decision-making process of deciding whether or not to engage in FDI they have to consider a wide range of factors and influences that may result in the success or failure of their investment. The factors that need to be considered are wide but generally all businesses will consider the political, economic and socio-cultural environment. As companies concentrate the analysis down to their own unique concerns, factors will be more focused on core business principles. A study by Shapiro (2001), for example, finds that the importance that investors attribute to specific risk factors depends to a large extent on the type of host country. Hayakawa et al. (2013) studied the influence of both political and financial risk on FDI but found mainly that political risk factors had a greater influence on FDI inflows than other sorts of risk.

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The most fundamental element in the promotion of economic growth in a developing economy is trust in the existing political and economic system within the country, and in the capacity for these systems to provide an environment conducive for development.\footnote{Stasavage, D. (2002), “Private investment and political institution”, Economic and Politics, Vol. 14 No. 1, pp. 41-63.} Building confidence in the governing bodies, however, is a complex, deliberate, and time-consuming task, requiring the establishment of appropriate institutions and bodies to properly govern and provide order.\footnote{Smarzynska, B. and Wei, S. (2000), “Corruption and composition of foreign direct investment: firm-level evidence”, NBER Working Paper No. 7969, National Bureau of Economic Research, Cambridge, MA. 29.}

Oman remains a monarchy in which decision making remains largely concentrated with Sultan Qaboos.\footnote{AMB Country Risk Report, Oman, 2014} But Qaboos is not only Sultan: throughout his reign has also formally held the position of Prime Minister, as well as the positions of Foreign Minister, Defense Minister, Finance Minister, and Central Bank Governor.\footnote{Kenneth Katzman, Oman: Reform, Security, and U.S. Policy, Congressional Research Service, 2016} This concentration of power gives Oman an uncertain political future that may be scaring off potential investors. The Sultan is aging, and has recently received intensive medical treatment over long periods of time. This makes planning investments difficult and he has no clear successor. The succession will be decided by a “Ruling Family Council” of his relatively small Al Said family. According to Article 5 of The White Book, Oman’s basic law, Qaboos’ successor must be a male descendant of Turki bin Said Sultan, sultan of Muscat and Oman from 1871-88. It is unclear exactly who this will be.\footnote{The White Book, The Basic Law of the Sultanate, 1996} If the family council cannot reach agreement within three days, the decision is to be based upon a sealed letter, written by Qaboos, to be opened upon his death. There are no confirmed accounts of whom Sultan Qaboos has recommended to be his successor. The succession issue has come to the fore since mid-2014 when Sultan Qaboos left Oman to undergo medical treatment in Germany, reportedly for colon cancer. The Sultan returned to Oman in late March 2015, but he has appeared in public only on a few major occasions.\footnote{Kenneth Katzman, Oman: Reform, Security, and U.S. Policy, Congressional Research Service, 2016}
The most visible issue regionally in the Middle East is clearly the lack of political stability. The Arab spring destabilized many regimes and Oman was not untouched. In 2011, protests occurred in the country that led to crackdowns on freedom of expression and assembly. However, the protests were limited and have not had a lasting effect on the stability of the country. According to AMB Country Risk Report 2015, Oman is a CRT-3 country with moderate levels of economic, political and financial system risk.

There are differing interpretations of Oman’s historical stability. Sir Arnold Wilson argues that Oman has always been the most isolated part of Arabia. Its appetite for political stability and reforms is well pronounced when reflecting on the Sultanates farsighted policies and decisions during the latter half of its renaissance. However, Oman has had several civil wars within living history: the Jebel al Akhdar War, the Dhofar, and skirmishes on the border with Saudi. Since these conflicts, a concentrated effort has been put in by the Sultanate to establish a political system that emphasizes stability and slow reforms through government development and investment policies. The goals of these polices include increasing the ease of doing business, eradicating corruption, improving education, legislation and taxation, promoting Omanization, and developing industry and infrastructure.

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332 AMB Country Risk Report, Oman, 2015
One of the touchstone events of this political reform was in 1996, when the government established a bicameral parliament consisting of an appointed Council of State (Majlis al-Dawla) and a wholly elected Consultative Council. However, the parliament does not have legislative powers and policies are implemented through Royal Decrees, which are commissioned by the Sultan. Furthermore, forming political parties and criticizing the Sultan is prohibited. According to the Heritage Foundation index (2013), the judiciary remains vulnerable to political interference. Such a weakness in terms of checks and balances on the power the executive within the political power structure means that legislation is vulnerable to the caprice of individuals and thus means that if there was to be fractures among the ruling class, then the business environment could be altered quickly.

In terms of the corruption index for the year 2015-16, Oman ranked 60th of the 168 countries that were ranked. This level of corruption in Oman is considered high. Furthermore, 33% of firms surveyed by the World Bank stated that they had bribed public officials. This does display that corruption is prevalent within the country, thus leading to negative effects of FDI inflows into the Sultanate due to improper functioning of the domestic market.

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335 Freedom House, (2013)
338 The World Bank, ‘World Development Indicators Table 5.2’, 13-December 2013.
Education is another area that does not appear to have developed to the standard required. At this current time the literacy rate in Oman is “85%” and the “annual public expenditure on education is 4% of GDP”. When contextualized it is evident that “education levels are below those of countries at similar levels of development”. This is a problem for the private sector in general. There is a concern that the education system is unable to produce a competent labour force with the necessary skills demanded by businesses resulting in its inability to best utilize and operate its quality infrastructure. Currently in Oman, “labor laws enforce the “Omanization” policy that requires private-sector firms to meet quotas for hiring native Omani workers.” The low-quality education in Oman means that there is a dearth of Omani labour that can meet such quotas. Although it is difficult to measure, it is easy to see how being forced to hire undereducated nationals would deter foreign investment. However, in an effort to counter such difficulties, so-called “free zones” have been established to allow for reduced levels of Omanization if a company is concerned that its business will not receive the adequately trained employees that it needs.

Despite these apparent political issues, Oman is one of the more stable countries within the region and accordingly “the Sultanate beat other Arab and African countries to take the top place in the region on the global stability index”. Despite insurrections early on in Sultan Qaboos’ rule, carried out by Dhofari tribesmen, the country has been characterised by peace for decades and Sultan Qaboos has now been in power for 46 years. This peace has seen Oman grow to what the Arab World Competitiveness Report refers to as a “transition” economy, one level below the highest-level economy, the “innovation-led” economy.

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340 Schwab & Gurria Ed. (2011) P75
341 Schwab & Gurria Ed. (2011) P18
343 A designated area, as of a city, where certain taxes or restrictions on business or trade do not apply
345 Schwab & Gurria Ed. (2011) P14
The analysis presented shows that the current level of political stability and the political structure would negatively affect the viability of FDI within the country. A point to note, is that the lines of succession and the progression following Sultan Qaboos remains unclear.\textsuperscript{346} This does make projecting the evolution of political stability in Oman on the long term a guessing game. FDIs are characterised by long-term interest and it would be in the Sultanate’s interest to have a transparent view on this vital decision. Qaboos has been instrumental in developing the current business environment in Oman and having a ruler that emulates his economic strategy will be of high importance. For the investor, the medium and long term political future of the Sultanate will be questionable as long as the successor is unknown. This will discourage them from deciding to invest in Oman.\textsuperscript{347}

It is also noteworthy that the Omani government has taken steps to develop further its protection of intellectual property. For example, the enforcement of intellectual property laws for pharmaceuticals and software improved in 2011.\textsuperscript{348} Of particular relevance is the fact that most of the intellectual property in the pharmaceutical and software industries that this legislation is designed to protect will have been developed by foreign companies, thus it is evident that the Omani government wishes to ensure that companies have their proprietary technologies protected, meaning the environment is becoming more suitable for innovative companies. This has provided the opportunity to attract multinational businesses to invest in Oman.

\textsuperscript{346} Kenneth Katzman, Oman: Reform, Security, and U.S. Policy, Congressional Research Service, 2016
\textsuperscript{347} Major uncertainty in the succession process. Governance is set to become more unpredictable in the future, and the Omani political system with the Sultan enjoying all-encompassing powers is largely unsustainable in its current form.
\textsuperscript{348} Heritage Foundation, (2013)
As a result of these positive changes, the ability of businesses to conduct operations within Oman has improved. An obvious indicator of this is that Oman has now reached 47th overall in the World Bank’s ‘Doing Business Indicators’.\textsuperscript{349} If one wished to start a business within Oman the procedure takes 8 days\textsuperscript{350} and it would cost 2.4%\textsuperscript{351} of the country’s income per capita for each business start-up. However other indicators complicate this positive reading. A potential issue for consideration would be the protection of investment, with Oman only registering a 5/10 on the Strength of Investor Protection Index\textsuperscript{352} and only receiving a 2/10 with regard to Ease of Shareholder Suits Index.\textsuperscript{353} This demonstrates that the legal reform and efforts to create a world-class business environment have not yet gone far enough. When coupled with the evidence of corruption within the country, it is reasonable to assess that there is some risk to the safety of FDI from both corruption and a low-level of investment protection in some areas. A number of studies by Al Mazani, Al Harab (2008), Elcomu and Hartoge (2012) have differentiated between two different trends in terms of the private sector’s involvement in forming economic policies in the Gulf region, including Oman. First, elite families which control many of the large businesses in Oman are using their power to influence policy in the Omani government and protect their own monopolies. These policies relate to labour law, the allocation of government subsides, and taxation.\textsuperscript{354} Secondly, as suggested by Hartog (2013) and Harab (2009), passive involvement from other groups of the private sector than business elite with little contribution in policy formation is attributable to the lack of mutual economic interests such as absence of taxation and the fact that the government-led jobs offer 80% employment to locals and 20% to foreigners, while in the private sector it seems the exact opposite, favouring foreigners over the locals. Both these factors weaken the negotiating power of developing the private sector.\textsuperscript{355} According to

\textsuperscript{349} World Bank, ‘Doing Business Indicators: Economy Profile: Oman’, Washington DC, USA. 2013, P1
\textsuperscript{350} World Bank 2013, P10
\textsuperscript{351} World Bank 2013, P10
\textsuperscript{352} World Bank 2013, P10
\textsuperscript{353} World Bank 2013, P10
\textsuperscript{354} As these policy makers are fully occupied by the government duties, this promotes a new way of doing business Kfalah, commission and sponsorship (as an easy way to earn money and to serve personal agenda).
\textsuperscript{355} Steffen Hertog (2012), Diversified But Marginal: The GCC Private Sector as an Economic and Political Force, the Center for Gulf Studies at the American University of Kuwait.
Hartoge (2010), the government contributing towards state spending in non-oil GDP for the most part remains considerably higher than in the rest of the world. The majority-share of private household consumption seems to be financed through civil wages, which dominate the total wage income of GCC nationals.

In many economies, government spending can drive business expansion, but business expansion in regular tax-based states also increases government revenue, which in turn allows higher expenditure. However this is not the case in Oman and other GCC countries. The causality runs in one direction only. The private sector activities rely on imports and pay little tax, which is utilised to provide public services for society as well as income support to jobless locals. Survival of the private sector is primarily dependent on government spending, which in turn is financed by external rents (oil and gas) making it the leading source of business growth. As a result of all the factors mentioned above, the private sector plays a marginal role in forming policy, having low representation and bargaining power. According to Fahim al Marhubi, despite improvements in the investment climate and environment for doing business, there are plausible reasons for believing that many markets in the sultanate remain vulnerable to anti-competitive practices. Chief among these are the existence of a few dominant but well-placed players with significant control of the flow of resources and opportunities, entry barriers due to poor distribution channels, regulatory and licensing regimes that continue to impede entry of new entrepreneurs, the possibility of bid-rigging in public procurement, and low access to finance for SMEs. Instead of creating incentives for work and innovation, such barriers to entry narrow the benefits of growth to a privileged few, thereby undermining employment and broad-based prosperity.
Turning to the economic factors, when coupled with the freezones that allow for easy movement of capital back to investors’ home country, it is evident that the fiscal environment of Oman is favourable to foreign direct investors. This is because Oman has a high level of economic freedom. According to the Heritage Foundation ‘2013 Index of Economic Freedom’, Oman ranks “45th freest.”\(^{356}\) This puts it well among the more developed economies of the world. Furthermore, Oman is ranked as “7th in the world” for fiscal freedom.\(^{357}\) This means that the fiscal environment within the country is characterised by the fact that there is no personal income tax, no consumption tax or value-added tax; and in addition, the “top rate of corporate tax is just 12 percent.”\(^{358}\) As a result, Oman stands as a great place to have profit-generating operations, as they would be maximised by the fiscal environment, which allows companies to operate at a taxation level that is among the best in the world. Such an environment makes Oman a solid FDI prospect for companies in any industry.

Despite the favourable level of fiscal freedom, the Omani domestic market is characterised by the low level of company registration and market capitalization. In 2005, the market capitalization for Oman was $USD 15,269 million and this grew to $USD 20,107 million in 2012, which equates to 28.2% of Omani GDP.\(^{359}\) When compared to the fact that the global average for market capitalization as a percentage of GDP is 76.2%,\(^{360}\) it is evident that Oman falls well behind in terms of how it has developed its capital markets: there are just 124 listed domestic companies.\(^{361}\) This shows that the domestic market in Oman is still small and is not up to global standards of development. However, from a FDI perspective the level of risk remains low. This presents a substantial amount of opportunity for multinational companies, as markets are not over-saturated. As large companies are likely to be based and listed outside of Oman, the lack of market capitalization will not be a massively detrimental as they are unlikely to be looking for funding through public offerings within the Omani securities exchange.

\(^{356}\) Heritage Foundation, (2013)
\(^{357}\) Heritage Foundation, (2013)
\(^{358}\) Heritage Foundation, (2013)
\(^{359}\) The World Bank, World Development Indicators: Table 5.4’, 18-Dec-2013.
\(^{360}\) World Bank, table 5.4,2013
\(^{361}\) World Bank, table 5.4,2013
The Omani population is just 3.3 million. The small domestic market and the limited number of potential customers may be seen as a risk by potential investors and so has a negative effect on the level of economic risk of FDI.\textsuperscript{362} Despite the implementation of an “Arab Free Trade Zone”\textsuperscript{363} which would give companies based in Oman easy access to 300 million people in 18 countries,\textsuperscript{364} this appears to be of little benefit to businesses based in the region. In fact, statistically the Arab world has “the lowest regional trade in the world at 10%”.\textsuperscript{365} Upon analysis, it is clear that there is very little opportunity for businesses that are selling high volume consumer products. Oman presents a moderate degree of logistical risk to investors, who will be concerned by a lack of diversity in Oman's transport network and high levels of trade bureaucracy. A further disadvantage of the size of the Omani population is the implication that this has for the labour force. One of the key reasons for this is that the female labour force participation is only 16.7%.\textsuperscript{366} Thus a substantial portion of the workforce is not active within the employment market.\textsuperscript{367} A higher level of workforce participation by women would greatly increase the pool of employees available to businesses as 73% of the population is of working age (15-64).\textsuperscript{368} Parallel to this, there is evidence that the labour force situation in Oman is not entirely negative in terms of the economic risk level of FDI. The labour force has grown by 5.5%, nearly 5 times the global average,\textsuperscript{369} thus we see that the situation is improving. A key point is that the balance of foreign-domestic workers within FDI companies is beneficial. Currently the percentage of Omani workers within the FDI companies has “reached 35.8% in 2011.”\textsuperscript{370} This substantial proportion means that the Omani government has a vested interest in making the situation as positive as they can for FDI companies but it also means that 64.2 % of the workforce within FDI organisations is made up of

\textsuperscript{362} The World Bank, ‘World Development Indicators: Table 2.1’, 18-Dec-2013.
\textsuperscript{364} Central Bank of Oman, June 2013. P13
\textsuperscript{366} The World Bank, ‘World Development Indicators: Table 2.2’, 18-Dec-2013.
\textsuperscript{368} The World Bank, Table 2.1. 2013.
\textsuperscript{369} The World Bank, Table 2.2. 2013.
\textsuperscript{370} Directorate General of Economic statistics, National Center for Statistics and Information, Sultanate of Oman, ‘Foreign Investment to Oman and Oman’s Investment Abroad’, June 2013. P13
foreign labour. This is of benefit to FDI firms as it means they can have far more choice of who they employ, particularly within the context of increasing Omanization programmes, as it appears that the Omani population is not large enough to provide the entire staff of FDI companies within the country.

The Omani workforce has grown swiftly compared to the rest of the world, and other economic statistics also display good levels of growth. Gross Domestic Product (GDP) has experienced substantial growth at a level of 4.8%, nearly double to global average. At this current level Oman has a GDP of $USD 70 billion. Furthermore, GNI in Oman reached $54.7 billion in 2011. This means that the GDP per capita is $USD 21,200 and thus Oman is classed as a high-income economy. As a result, FDI companies involved in industries such as tourism, will receive a boost from local populations that have income to spend on leisure activities. Broadly speaking this is positive for all FDI companies as it means that the country is far more prosperous and thus has achieved a substantial level of development.

Another key metric for the health of an economy is the level of the country’s exports. Oman exported “62%” of goods and services in 2012. This displays that Oman is has a strong culture of exporting and thus will be suitable for organisations looking to ship goods globally from the country. However, only 0.1% of these exports were high technology and this demonstrates that Oman is unlikely to be a strong candidate for FDI from technology countries. A general area of risk for all companies engaging in FDI within Oman is that there is a low level of domestic credit to the private sector. The level of domestic credit is currently at 41.2% of GDP, quite a bit lower than the global average. This could have implications for businesses that require further investment in their FDI operations in Oman. The climate is far more suitable to businesses that will be able to self-sustain and self-fund projects.

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371 The World Bank, ‘World Development Indicators: Table 4.1’, 18-Dec-2013.
372 The World Bank, ‘World Development Indicators: Table 4.10’, 18-Dec-2013.
373 The World Bank, Table 4.10, 2013.
374 The World Bank, ‘World Development Indicators: Table 4.8’, 18-Dec-2013.
375 The World Bank, ‘World Development Indicators: Table 5.12’, 18-Dec-2013.
376 The World Bank, Table 5.1. 2013.
That being said, there are FDI opportunities in Oman, but it might be look risky in the eyes of investors. This is because of an uncertain political future, the large bureaucracies, and the unfair influence of elite families on maintaining monopolies.

### 3.1 Structure of Omani Economy

A close examination of the scale of transformation Oman has undergone in the last few decades stands evidence to the fact that the country has spectacularly thrown off years of stagnation and backwardness.\(^{377}\) Prior to 1970 Omani social and economic infrastructure was almost non-existent.\(^{378}\) In 1970, Oman had only two hospitals, three schools and 15 kilometres of paved roads.\(^{379}\) Economic activities relied heavily on agriculture and fisheries, GDP was only RO 104 million and per capita income, RO 158.\(^{380}\)

In the last four decades the overall Omani economy has performed well. Oil wealth has been utilized to enhance economic and social infrastructure, resulting in an extensive and efficient road network and substantial improvements in the quality of health and education. In 2011 Oman had 65 hospitals and 186 health centres, 1037 schools and 29,685 kilometres of paved roads.\(^{381}\) On the economic front, in 2011 GDP reached RO 27854 million and per capita income reached RO 7792.\(^{382}\) Mansur and Treichel (1999) have found that besides having one of the highest growth rates in the world for several decades, Oman also experienced persistent growth in non-oil GDP, financial stability, confidence in the economy and a stable currency.\(^{383}\)

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\(^{377}\) Credit for the vast transformation goes to His Majesty Sultan Qaboos Bin Said’s prudent policies and initiatives.

\(^{378}\) According to Arab German Consulting 1998, Oman dates back to around 3000 BC and relates to export of copper to Sumeria. Oman was known as Megan at that time and had a reputation throughout the gulf and the Indian sub-continent for quality copper.


\(^{380}\) Oman’s modern history started with H.M. Sultan Qaboos coming to power in 1970. In his first speech to the nation, Sultan Qaboos said, "I promise you to proceed forthwith in the process of creating a modern government. I will proceed as quickly as possible to transform your life into a prosperous one with a bright future. Every one of you must play his part towards this goal”.

\(^{381}\) Statistical year book 2012, Supreme Council for Planning, Oman

\(^{382}\) Statistical year book 2012, Supreme council for planning, Oman.

performance continued to remain robust, characterized by strong GDP growth, significant creation of job opportunities, and large surpluses in the fiscal and balance of payments positions.\(^{384}\) Despite the fact that non-oil sectors achieved a significant growth in the past years; oil is still the main engine of growth and development in the Omani economy. However, Oman is actively pursuing a development strategy that focuses on diversification, with the objective of reducing the oil sector's contribution to GDP to 9% by 2020 from 35% in 1995.\(^{385}\) On the social front, the United Nations Development Programme (UNDP 2012) has rated the Sultanate of Oman amongst the group of countries with the highest human development, taking into account the quantum leaps achieved in the fields of health and education.\(^{386}\) That being said, major challenges remain; more than two-thirds of the population (67%) is under 24 years old, posing a major challenge in the areas of education and the need to create more jobs to absorb the rising numbers of Omanis entering the labour market. GDP growth over the years has been largely driven by crude oil prices in the international market and the effects of crude oil prices are also manifested through the inflation rate, employment, investment and savings.\(^{387}\) Oman was able to achieve a high growth rate and development within the past four decades. The growth was mainly driven by oil activities. Consistent with the objective of the strategy of economic diversification that underpins long-term development strategy (1996-2020) in the quest for sustainable development, the share of oil activities in GDP dropped from 69% in 1970 to 53% in 2011. Therefore, the share of the non-oil activities improved from 31% in 1970 to 47% in 2011.\(^{388}\) Public finance information shows that Oman pursued an expansionary fiscal policy through the expansion of government total expenditure, particularly investment expenditure on development projects and public health and education services. The overall fiscal balance of the government was robust during the last decades, mainly due to significant increase in government revenues. The marked improvement in the overall fiscal

\(^{384}\) As per “The Growth Report” published by the Commission on Growth and Development, the Sultanate of Oman is one of 13 countries with high, sustained growth in the post-war period.


\(^{386}\) The 2010 UN Human Development Report ranked Oman first in improving human development over the last four decades.

\(^{387}\) Oman Country Profile (2008), The Road Ahead for Oman, Economic Research Forum.
balance was for the most part attributed to large oil revenues arising out of higher crude oil price in the international markets despite weak global economic recovery.

A number of factors, including those related to geopolitics, natural disaster in Japan, growth among the emerging and developing economies, and price speculation in the international markets, contributed to the increase in crude oil prices. Government revenues jumped to RO 12,491 million in 2011 compared to RO 5.45 million in 1970. The oil revenues grew remarkably, thereby contributing to a significant proportion of the increase in total revenues. The share of oil revenues in total revenues was 97% in 1970, dropping to about 87% in 2011. The increase in oil revenues was due to an increase in oil production from an average of 332,000 barrels per day in 1970, produced from 63 oil wells to about 885,000 thousand barrels per day in 2011, produced from 162 oil fields. The average oil price also rose to $102.95 per barrel in 2011 compared to $1.82 per barrel in 1970. Total expenditure is the main engine of economic activities in Oman. It increased to RO 10596 million in 2011 compared to RO 2,016 million in 1970. This reflects the Government's interest in improving the standard of living and providing quality health and education services, besides the completion of the infrastructure projects such as roads, ports, and the enhancement of productivity, especially in the oil and gas sectors, and support for economic diversification programmes. In term of foreign trade and balance of payments, it is important to note that Oman is a small, open, outward-orientated economy. It witnessed significant achievements associated with the conditions of foreign trade and balance of payments, where the total value of exports and imports of goods and services as a percentage of GDP increased to 98.7% in 2011. This reflects a high degree of openness of the national economy and its integration into the global economy.

389 According to a World Bank report, using enhanced oil recovery techniques, Oman succeeded in increasing oil production, giving the country more time to diversify, and the increase in global oil prices through 2011 provided the government greater financial resources to invest in non-oil sectors. The source of oil price in 1970 is: Ministry of Commerce and Industry, Omani Economy in Ten Years, 1970-1980, 1989, p.430.
390 According to H.E Darwish Ismail, Omani finance minister, increases in social welfare benefits and creation of more jobs in the government sector, will challenge the government's ability to effectively balance its budget if oil revenues decline.
Table 3.1 Trade Balance 2002-2011

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade Balance(RO billion):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>2129</td>
<td>9841</td>
<td>362.2</td>
</tr>
<tr>
<td>Oil Exports</td>
<td>4296</td>
<td>18107</td>
<td>321.5</td>
</tr>
<tr>
<td>Non-Oil Exports</td>
<td>3308</td>
<td>12826</td>
<td>287.7</td>
</tr>
<tr>
<td>Re-exports</td>
<td>261</td>
<td>3033</td>
<td>1062.1</td>
</tr>
<tr>
<td>Imports</td>
<td>-2167</td>
<td>-8266</td>
<td>281.4</td>
</tr>
</tbody>
</table>

Source: Statistical year book 2012

Figure 3.1 Composition of Omani Merchandise Exports in 2011

As can be seen from Table 3.1 and Figure 3.1 the composition of merchandise exports of Omani origin have witnessed a remarkable development, its relative share in total exports increasing from 4.3% in 1970 to 17.0% in 2011. The trade balance has been significantly influenced by oil and gas exports, which accounted for 71% of total exports in 2002 and 59% in 2011. Over time, the share of oil exports in total exports has generally decreased due mainly to an increase in non-oil exports and liquefied natural gas (LNG).
Inflation trends over the years have been driven by both internal and external factors. In general, Oman enjoyed low rates of inflation until 2006. However, the inflation rate rose in 2007 and 2008. It increased from 3.2% in 2006 to 5.9% in 2007 and then jumped to 12.4% in 2008. The increase in inflation reflected rising world food prices, supply-side constraints related to the construction boom, upward pressures on wages, and the depreciation of the U.S. dollar.

The world food crisis in 2008 meant that most food items, which are imported in Oman, were more expensive. Similarly, the depreciation of the US dollar against major currencies has increased the pass-through inflation given the increase in costs of imported goods and labour, although the precise magnitude of pass-through needs to be ascertained econometrically. In 2009 and 2010 the inflation rate in Oman fell to 3.4% and 3.3% respectively. This reflected declining commodity prices in the global market as a result of contraction in global demand due to the global financial crisis and the accommodative monetary policy pursued by the Central Bank of Oman. However, the inflation rate increased slightly to 4% in 2011.

In terms of the financial sector and monetary developments, the institutional framework of the financial sector came under the jurisdiction of the Central Bank of Oman comprised mainly commercial banks, specialized banks, non-bank finance and leasing companies and money exchange establishments dealing exclusively in money exchange and a few authorized to engage in remittance business as well. As at the end of 2011, the number of commercial banks stood at 17, of which seven were incorporated locally and 10 were branches of foreign banks.

The Omani monetary policy is anchored in the fixed peg regime to the US dollar and its main objective is to maintain price stability while promoting growth. The banking sector has performed well. The financial sector faces challenges in funding the Sultanate’s future economic development in a sustainable manner. The challenges stem from the Sultanate’s relatively small financial market, low private savings,

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391 Thanks to the policy of linking the Omani Rail to U.S. dollar and coordination between fiscal and monetary policies
393 IMF, 2008
concentration and competition, inefficient monetary policy structure, and regulatory shortcomings. According to IMF, the financial sector in Oman is considerably small, relative to other countries with a comparable per capita income level. The aggregate size of the Sultanate's financial assets stood at 95.6 percent of GDP in 2007 when the Sultanate's per capita income level was USD 15,538. This compares to 219.4 percent of GDP for the estimated size of financial assets in a country with the same per capita income.

According to the IMF, the financial sector in Oman is considerably small, relative to other countries with a comparable per capita income. The aggregate value of the Sultanate’s financial assets stood at 95.6 percent of GDP in 2007 when the Sultanate’s per capita income was USD 15,538. This compares to 219.4 percent of GDP for the estimated value of financial assets in a country with the same per capita income. A notable development in the banking sector in 2011 was the authorization of Islamic Banking in Oman following Royal Directives in this regard. Two new local banks have been licensed to offer Sharia compliant products while all commercial banks operating in Oman can open windows to practice Islamic Banking under licence from the Central Bank of Oman. One important constituent for macroeconomic stability in Oman has been the fixed exchange rate peg to the US dollar, which has helped in managing volatility. For a variety of reasons, Oman has adopted the fixed exchange rate regime to gain several benefits including those for small open economy with open capital account convertibility, as the fixed rate regime insulates the country from bilateral exchange rate fluctuations. As Abed, Erbas, and Guerami (2003) demonstrate, the peg provides a safe and credible nominal anchor for monetary policy. By clearly anchoring inflationary expectations at low levels and providing certainty about future exchange rates, the peg is relatively easy to administer and does not require independent monetary policy. Finally, the peg makes Omani interest rates closely tracking the US rates in the medium and long terms. However, this regime is used to maintain the exchange rate peg and cannot be used for domestic objectives.

In term of national development planning, there have been two long-term strategies in Oman. The implementation of the first Long-Term Strategy (1970-1995) was successful. Oil revenues are a major contributor to Oman’s fiscal resources and significant capital investment was made in Enhanced Oil Recovery techniques (EOR) to further exploit this resource. However, the need for diversification was recognized. The two major issues which faced the Omani economy at that time were declining oil reserves and management of fiscal revenues and associated risks. In moving forward, Oman addressed these issues by extensively investing in EOR techniques to counter declining reserves and minimize total expenditure. The second long-term development strategy (1996-2020) built on the results of the first strategy. Among the important objectives of the 2020 Vision are promoting Omanization including increased interest in better education systems, using oil revenues to create new markets within Oman with the aim of diversifying away from oil dependence and to control rural-urban migration, among other issues, by reducing inequality in terms of spending and infrastructure development. The development in Oman took several phases through five-year development plans.

3.2 Dominant role of the Public Sector

As in most oil-based economies such as the Omani economy, primary income accrues mainly to government as the owner of the natural resources (oil and gas). This helped the government play a major economic role as investor, provider of social services and infrastructure and in some production activities. The hydrocarbon sector plays a dominant role in the overall economy of the Sultanate.

Table 3.2 The Hydrocarbon Sector dominance role 2002-2011 (%)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>2011/2002</td>
</tr>
<tr>
<td>Total Exports including re-exports</td>
<td>81.4</td>
<td>70.8</td>
<td>-13</td>
</tr>
<tr>
<td>Exports of Omani origin</td>
<td>92.67</td>
<td>80.87</td>
<td>-12.7</td>
</tr>
<tr>
<td>Net Fiscal Revenue</td>
<td>75.66</td>
<td>77.4</td>
<td>2.3</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>52.56</td>
<td>50.9</td>
<td>-3.2</td>
</tr>
</tbody>
</table>

Source: Statistical year book 2012
Consequently, the high degree of dependence on the hydrocarbon sector has affected Oman’s traditional economy negatively.\textsuperscript{397} Agriculture and fishing, for example, have been impacted negatively with their share in GDP dropping from 75% during the 1960s to 15.8% in 1970.\textsuperscript{398} This further declined to 2.7% in 1980 and to 2.5% in 1996 and to 1.4% in 2005. However, the *long-term Vision 2020* aims at increasing the share of this sector to 3.1% for agriculture and 2% of GDP for fishing by 2020. Moreover, the industrial sector, which contributed 8.4% to GDP in 1970 declined to 6.4% in 1980 but increased to 17.8% of GDP in 2011. The Vision 2020 allocated this sector a paramount importance in the diversification strategy, with the aim of raising its share of GDP from 6.8% in 2000 to 15% by 2020. According to the World Bank energy sector review, 2009, Oman’s geology relative to that of other countries in the Middle East makes drilling for oil and gas more difficult. It is rated among the highest in terms of average well depth at over 1,200 meters, resulting in extra production cost.\textsuperscript{399} First, oil is produced in either the extreme South or the extreme North and pumped to Mina Al-Fahal in Muscat. Second, due to geological reasons, Oman’s oil is relatively expensive to produce, hovering around US $6-8 per barrel,\textsuperscript{400} while in Saudi Arabia, for example, it is less than $1.5 per barrel and the worldwide average is US $5 per barrel. Oman appears to have the highest exploration and drilling activity in the region.\textsuperscript{401} Oman oil reserves have generally been on a declining trend. However, starting from 2006, reserves increased due to EOR technique. Omani oil production has fluctuated over time. A steady increase was witnessed from 283,000 bpd in 1980 to 498,000 bpd in 1990, and then to 955,000 bpd and 884,900 bpd in 2000 and 2011 respectively. In recent years both oil production and reserves have generally been on a declining trend. In order to reverse this trend, the government adopted two policies. First, it increased its capital expenditure on

\textsuperscript{397} This phenomenon is known as 'Dutch Disease'. Literature shows a country that relies on natural resources, often affected by it. It occurs when domestic spending increases as a result of discovery or development of a natural resource, accompanied by an increase in public revenues and expenditures. This leads to an increase in domestic services’ prices relative to domestic tradable goods, which means an enhancement to real exchange rate.

\textsuperscript{398} Oman Vistas "Economy on Threshold of Major Diversification", p. 16, 2006-07 Special Edition

\textsuperscript{399} However, it gives Oman an extra advantage over other oil states of the region as its oil is shipped from outside of the politically unstable Gulf area. For example, in case of any hostilities in the region, the only safe ports out of the Gulf basin equipped to export oil are the Omani ports of Sohar and Al Fahal.

\textsuperscript{400} Stauffer, Thomas (1990), *The Economic Cost of Oil or Gas Production: a Generalized Methodology*. OPEC Review, Volume 23 Issue 2, p. 193

\textsuperscript{401} WB (2010a) energy report
high-tech EOR techniques. Williams (2007) states, "Oman's Oil & Gas Ministry plans to spend $10.000 million over the next five years on boosting production from its ageing fields".\textsuperscript{402} This will increase both the reserves and production. At the end of 2011, Oman’s proven oil reserves were estimated at 5.5 billion barrels\textsuperscript{403}, which is significantly lower than some of its oil-producing neighbours. The country’s crude reserves, based on 2011 production levels, will permit a minimum period of 25 years of output. Table 3.3 indicates that Oman will be one of the first to exit from the Gulf States Oil Club.\textsuperscript{404}

### Table 3.3 Oil reserves in the GCC, 2002 and 2011, In billion barrels

<table>
<thead>
<tr>
<th>Countries</th>
<th>2002</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAE</td>
<td>97.8</td>
<td>97.8</td>
</tr>
<tr>
<td>Bahrain</td>
<td>0.13</td>
<td>.10</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>262.79</td>
<td>265.4</td>
</tr>
<tr>
<td>Qatar</td>
<td>15.21</td>
<td>24.7</td>
</tr>
<tr>
<td>Kuwait</td>
<td>96.5</td>
<td>101.5</td>
</tr>
<tr>
<td>Oman</td>
<td>5.71</td>
<td>5.5</td>
</tr>
</tbody>
</table>

Source: British Petroleum (BP), 2011 Statistical Review

Second, the government granted licences to independent companies based on “yields sharing” and without financial obligations on its part.\textsuperscript{405} The current wave of increasing oil prices has encouraged many international companies, mainly Chinese and Indian, to bid. The competition among these companies was described by Warren as one of the factors enabling capitalist development in the Third World.\textsuperscript{406} Natural gas is the second source of Oman’s wealth.\textsuperscript{407} As with oil, gas reserves in Oman are not as large as those available in other Middle Eastern countries. However the trend has been upwards with gas reserves increasing, from 12.3 trillion cubic feet (cft) in 1992

\textsuperscript{403} CBO annual report (2011), p.38
\textsuperscript{404} International Energy Agency, World Oil Market Report
\textsuperscript{405} Ministry of Oil and Gas
\textsuperscript{407} The recent trend of the energy market for environmentally friendly energy makes it an important source of potential revenue.
to 34.6 tcf at the end of 2008, and then dropping to 18.18 cft in 2011. In terms of production, the production of natural gas registered an increase of 4.4 percent to 34,716 million cubic meters in 2011. In addition to exporting gas, Oman has established many gas-based projects such as fertilizers, cement, aluminium and petrochemicals. The aim of doing so was to prepare the economy in case the oil era came to an end.

In terms of saving and investment position in Oman, investment is one of the key components that contribute to the increase of production and production capacity of a society measured by GDP. On the demand side, investment creates demand for goods and services required for projects, and on the supply side it adds to the capital accumulation and hence increases supply. In order to enhance growth and sustainability countries strive to boost investment. The growth process in an economy is conditioned largely by both factor endowment and factor productivity. Capital is an important factor of production, and higher levels of capital formation generally add to the production capacity of a country. In the case of Oman, the total investment for the Five Year Plan period increased from RO 671.3 million in the 1st Plan (1976-1980) to about RO 30 billion in the 8th Plan (2011-2016). Recognizing the importance of annual capital formation to sustain the growth momentum in Oman, the national accounts data released by the Omani Supreme Council show that Oman’s gross capital formation increased to about RO 7082.2 million thereby accounted for 26.9 percent of GDP in 2011 from about RO 977.2 million (12.5 percent of GDP) in 2002. Also, Oman’s gross domestic saving as a percentage of GDP increased significantly from 33.1 percent (about RO 1502.3

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411 Spending for (the production and accumulation of) capital goods (human made resources, machinery and equipment) used to produce goods and services which do not directly satisfy human wants and additions to inventories.
412 Gross fixed capital formation represents the value of all acquisitions less disposal of fixed assets by all producing units in a country. Fixed assets for this purpose represent both tangible and intangible assets that are produced as output from the processes of production, but subsequently they get used repeatedly or continuously in other processes of production for more than one year.
413 Gross domestic saving is the difference between GDP and total consumption.
million) in 2002 to 53.0 percent (RO 14261.7 million) in 2011. This increase in both gross capital formation and domestic saving was primarily driven by the large fiscal surpluses resulting from oil price hikes. However, a part of the gross domestic saving (which is GDP minus consumption) leaked out of the system in the form of current transfers (i.e. remittances by expatriates working in Oman) and primary income (i.e. interest and dividends paid on external liabilities).

Table 3.4: Gross Capital Formation by components (RO million) 2002-2011

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Gross Capital Formation at Current Prices (RO mln.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Building and Construction</td>
<td>383.5</td>
<td>907.8</td>
<td>1470.9</td>
<td>2978.7</td>
<td>3214.2</td>
<td>3535.5</td>
<td>1935.74</td>
</tr>
<tr>
<td>(ii) Machinery &amp; Equipment</td>
<td>322.1</td>
<td>1244.6</td>
<td>1600.6</td>
<td>3411.9</td>
<td>2385.9</td>
<td>2813.8</td>
<td>1861.72</td>
</tr>
<tr>
<td>(iii) Intangible Fixed Assets</td>
<td>264.9</td>
<td>273.9</td>
<td>355.3</td>
<td>637.4</td>
<td>661.3</td>
<td>732.9</td>
<td>461.27</td>
</tr>
<tr>
<td>Change in Inventories**</td>
<td>6.7</td>
<td>215.7</td>
<td>327.2</td>
<td>835.7</td>
<td>-630.7</td>
<td>-771.5</td>
<td>-165.22</td>
</tr>
<tr>
<td>B. Gross Capital Formation as % of GDP</td>
<td>12.5</td>
<td>25.6</td>
<td>24.2</td>
<td>30.1</td>
<td>27.5</td>
<td>26.9</td>
<td>25.07</td>
</tr>
<tr>
<td>C. Gross Domestic Saving (RO mln.)</td>
<td>2584.3</td>
<td>3842.9</td>
<td>7135.4</td>
<td>12843.7</td>
<td>10997.7</td>
<td>14261.7</td>
<td>7544.52</td>
</tr>
<tr>
<td>Net primary income from abroad</td>
<td>-481</td>
<td>-150</td>
<td>-352</td>
<td>-1061</td>
<td>-1214</td>
<td>-1230</td>
<td>-422.8</td>
</tr>
<tr>
<td>Net current transfers from abroad</td>
<td>-601</td>
<td>-739.7</td>
<td>-1119.1</td>
<td>-2039</td>
<td>-2240</td>
<td>-2821</td>
<td>-1465.48</td>
</tr>
<tr>
<td>D. Gross National Saving</td>
<td>1502.3</td>
<td>2953.3</td>
<td>5664.3</td>
<td>9743.7</td>
<td>7543.7</td>
<td>10210.7</td>
<td>5441.85</td>
</tr>
<tr>
<td>E. Gross Domestic Saving as % of GDP</td>
<td>33.1</td>
<td>40.5</td>
<td>50.4</td>
<td>55.0</td>
<td>48.3</td>
<td>53.0</td>
<td>45.27</td>
</tr>
<tr>
<td>F. Gross National Saving as % of GDP</td>
<td>19.2</td>
<td>31.1</td>
<td>40.0</td>
<td>41.7</td>
<td>33.1</td>
<td>38.0</td>
<td>32.45</td>
</tr>
</tbody>
</table>

Source: statistical year book 2012

As a result, Oman’s gross national saving as percentage of GDP was much lower at 38 percent (about RO 10210.7 million) in 2011, implying leakage equivalent of as high as 12.7 percent of GDP under net primary income and net current transfers.\(^\text{414}\) Oman has generally been a net exporter of capital, with part of its national savings getting invested abroad, which is also corroborated by the surpluses seen in the goods and services account of Oman’s balance of payments.\(^\text{415}\) In most years, the Sultanate has been able to achieve current account surpluses, implying that parts of the national savings have been invested overseas. As seen from table 3.4 in 2011 the total national saving available stood at about RO 10210.7 million, which accounted for 53% of the GDP, while the national savings available for investment domestically (i.e.

\(^{414}\) National savings available for investment had been insufficient due to the large outflow in income account (form of payment of dividend, and interest to non-resident) in addition to private transfers paid as worker remittances.

capital formation) stood at RO 7082.2 million (a result of the outflow of RO 3128.5 million under the current account), which is equivalent to 31% of the GDP. The current account surplus was around RO 2103 million, an amount equal to the outflow of national savings being invested overseas either by the household, private sector or the government.416

Given the open nature of the Omani economy, this type of asymmetry between domestic saving and domestic investment may be unavoidable, even if there is increased domestic saving, in particular given the better investment opportunities that are available overseas. Thus, providing incentives that would increase national savings and translate these savings into investment is extremely important for the Sultanate of Oman. Failing to invest these savings may lead to a fall in aggregate demand, and subsequently to lower economic growth, in particular in time of low oil prices. It is, therefore, incumbent upon financial institutions in Oman to channel savings in accordance with the needs of productive investment, which is essential for achieving long-term growth. Increase in the level of investment, both domestic and foreign, reflects an increase in production capacity of the economy, as investment spending plays a dual role in the economic system. On the demand side, increase in investment creates demand for goods and services necessary for the projects, and on the supply side it adds to the capital accumulation and thus increases supply. The average GDP share of national savings was 32.45% during 2002-2011. It is worth mentioning that the GDP share of national saving is considered inadequate and far below the optimum level. For instance, the GDP share of national saving was 19.2% in 2002 which very nearly doubled to 38% by 2011, but remained less than the optimum level calculated and suggested by the World Bank (39%).35 According to the World Bank report, Oman 2020 – Financial Sector Note 2009, the public sector plays a critical role in the resource balance of Oman; statistics show the dominance of public investment over private investment. This is reflected in the fact that the relative share of public capital formation in gross capital formation ranged between 63.5% and 65.3% in 2002 and 2006 respectively. The case is more serious for the private sector where the relative share of public capital formation in gross capital formation

416 The current account surplus takes the form of investment as well as reserves of the Central Bank of Oman and the foreign assets of the government.
ranged between 36.5% and 34.7% in 2002 and 2006. The average public saving rate during the same period was 22.1 percent of GDP, compared to the average private saving rate of 4.8 percent. In other words, public saving accounted for 82 percent of national saving on average during the period 2002 - 2008. Reflecting its dominance in gross national savings, the public sector dominated gross capital formation as well. The average gross capital formation rate of the public sector during the same period was 12.8 percent of GDP, compared to 5.8 percent of the private sector. The average gross domestic saving rate increased from 33.1% in 2002 to 53% in 2011. This increase in gross domestic savings stemmed from a decrease in budget deficits due to an increase in oil revenues. In contrast, private saving rates hovered at 5 percent on average during the period 2002 - 2011. This low private saving rate is unusual in a country with a high income level when income and saving have a strong positive relationship. The amount of money that the financial sector could intermediate was far less than the Government provide. According to the national accounts data released by the Government, gross capital formation in the form of ‘building and construction’ increased to RO 3535.5 million in 2011 compared to RO 383.5 million in 2002, an average of RO 1935.7 million during the period 2002 - 2011. Capital formation in terms of ‘machinery and equipment’ also rose to reach RO 2813.8 million in 2011 compared to RO 322.1 million in 2002, an average of RO 1861.72 million during the period 2002 - 2011. The growth of public investment for creating physical infrastructure in the country and the general boom in the construction sector contributed significantly to strengthen the country’s capital formation. The share of the hydrocarbon sector in the gross capital formation of the country was 29.5 percent in 2011 compared to 30.5 percent in 2002 while the remaining part of the investment was contributed by non-oil activities. Government investment expenditure accounted for 33.1 percent of the total capital formation in 2011 which explains the predominant role played by the Government in sustaining investment growth in the country. The gross capital formation of a country is generally financed by

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417 Calculated from Table 1 in IMF Article IV Report 2007
418 Calculated from data tables in CBO Annual Reports from 1995 to 2008
419 Gross capital formation in Oman consists of fixed capital formation and fluctuation in inventories. It is defined as the value of all acquisitions of fixed assets by all producing units, less disposable assets. Fixed assets account for both tangible and intangible assets that are produced as output in production process and are then used continuously in other production processes for more than a year.
domestic savings, supplemented by the foreign savings, i.e. inflow of capital to finance the current account deficit. In the case of oil exporting countries such as Oman, domestic savings often exceed investment due to the current account surplus leading to outflow of capital for the creation of assets abroad. Information on Oman’s saving and capital formation indicates a clear link between oil price and saving and investment balance.\footnote{For example as crude oil prices declined significantly in 2009, public saving shrank drastically resulting in gross domestic saving as proportion to GDP falling to 41.4 percent in 2009 compared to an average rate of 51.4 percent during the previous three years. However, with the rise in average oil prices, gross domestic saving as proportion to GDP recovered to 48.3 percent in 2010.}

3.3 Size and Role of Private Sector in Omani Economy

The private sector is an important part of any given economy; it is an essential component to boost the growth and stability of economies worldwide. It generates more jobs and makes a significant contribution to sustainable development.\footnote{World Bank, From Privilege to Competition Unlocking Private-Led Growth in the Middle East and North Africa, Mena Development Report, 2009} The private sector has been central in all countries that have grown strongly over long periods. The Commission on Growth and Development\footnote{The private sector is a critical partner in economic development, a provider of income, jobs, goods, and services to enhance people’s lives.} found in their 2008 report five common characteristics of countries with high-sustained growth. While many of these characteristics relate to actions that governments need to take, also prominent among these is market allocation of resources, led by the private sector.\footnote{Private firms and entrepreneurs invest in new ideas and new production facilities.} According to the same report, in most countries, the private sector is the major component of national income, the major employer and creator of jobs.\footnote{Ashraf Mishrif (2010), Investing in the Middle East, Tauris Academic Studies.} Over 90 percent of jobs in developing countries are in the private sector. The pace of job growth and the quality of employment in the private sector are thus central to development.\footnote{World Bank (2005), World Development Report 2005: A Better Investment Climate for Everyone, Washington, DC: World Bank.}
As illustrated in figure 3.2, the private sector is the main driver of the development process in advanced and a number of emerging economies, while in most oil-based economies such as the GCC countries, primary income accrues mainly to government as the owner of the natural resources (oil and gas). This helps the government to play a major economic role as investor, provider of social services and infrastructure and to engage in some production activities.  


The literature highlights several potential factors to be the key determinants of private sector development; these factors can be classified into factors related to government and factors related to private sector itself. In this part, we will address the pre-conditional factors for private sector led growth to materialize: The absorptive capacity is an important factor affecting the extent of private sector development, although it is important to distinguish between absorptive capacity at the firm level and in the country level. Absorptive capacity at national level is shown by such indicators as per capita income, trade openness, and the level of education that the labour force has attained, the level of development of financial markets, technology use efficiency and domestic research and development. At firm level, it is linked to quality of
human capital, and of management, highlighting the role of education and management training policies. The importance of R&D in expanding the technology frontier is discussed by Aghion and Howitt (1992) and Grossman & Helpman (1991). The dominant variable in most studies is the standard of education of the labour force, which is also described as “social capability”, a threshold level of human capital and human capital formation.\textsuperscript{427} The literature highlights five important elements related to absorptive capacity, namely human capital, research and development capacity, institutional framework, financial market, policy environment and intellectual property rights. Oman seems to have a weak and somewhat inefficient private sector in terms of economic diversification, capital formation and employment generation for nationals, and largely depends on the government.\textsuperscript{428} This part aims to provide better understanding of the whole set of complex factors preventing private-led growth in Oman, positioning it as an engine of inclusive growth and prosperity for the gulf region.\textsuperscript{429} Statistics indicate the weak performance of the private sector during the study period. Although there is a significant improvement in private sector performance,\textsuperscript{430} Oman has yet to reach the target level, even with the great support received from the government through the enactement of laws, infrastructure development, provision of various types of incentives and support to the private sector, commitment to market mechanisms in resource allocation, and encouraging free competition to stimulate innovation.\textsuperscript{431} The Omani government understands that the state-led development scenario used previously will not be able to sustain long-term growth and address challenges and there is an urgent need to move to a new scenario with a larger role for the private sector.\textsuperscript{432} Much has been done but still more remains to be done to align


\textsuperscript{428} World Bank (2010b) Vision 2020 assessment

\textsuperscript{429} Inclusive growth refers to a focus on economic growth that is both broad-based across sectors and inclusive of the large part of the country’s labour force.

\textsuperscript{430} On the positive side, countries in the region actually started exporting more products over the last decade. Liberalization and greater openness increased the capacity of the domestic private sector to export, with a more diversified basket of goods.

\textsuperscript{431} Steffen Hertog, Giacomo Luciani, Dr Marc Valeri (2013), The Politics of Business in the Middle East After the Arab Spring, Hurst.

\textsuperscript{432} Creating jobs for a young and better-educated labour force is a top priority of all governments.
the incentives of profit maximizing in the private sector with the social objectives of shared growth and job creation. As indicated in various World Bank reports, the private sector in developing countries, including Oman, faces many constraints in such areas as finance, infrastructure, employee skills, and the investment climate. As can be seen from Tables 3.4 and 3.5 and Figures 3.3 and 3.4 the private sector in Oman is characterized mainly by businesses that are personal or family-owned, offering low-wage and low-skill employment, resulting in the fragmentation of this sector to small enterprises that lack the financial means and skills needed for doing business on a large scale.

Table 3.5: Characteristics of Enterprise - Ownership

<table>
<thead>
<tr>
<th>By Ownership</th>
<th>2002</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Capital OR</td>
</tr>
<tr>
<td>Full Omani Ownership</td>
<td>436</td>
<td>428898817</td>
</tr>
<tr>
<td>Mixed Ownership</td>
<td>354</td>
<td>319253258</td>
</tr>
<tr>
<td>Full Foreign Ownership</td>
<td>82</td>
<td>109645559</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

* Provisional
Source: Under-secretary office, Ministry of Commerce and Industry

In fact, private sector enterprises favour the hiring of expatriates who accept lower wages, require less training and are subject to more flexible labour market regulations, compared to the local workforce.
Developing a strong private sector that is able to ensure a growth pattern that generates productive employment opportunities for nationals and becomes the leading sector in the national economy is a top priority in all vision and development plans. However, despite the many successes, Oman has still not been able to achieve this objective. This part will dwell a little on the role and contribution of the private sector in the main economic areas, followed by challenges that prevent strong performance.

**Figure 3.3: Positive Private Sector Characteristics in Oman**

**Source: Compiled by author**

**Figure 3.4: Negative Private Sector Characteristics**

**Source: Compiled by author**
Table 3.6: Characteristics of Enterprise - Legal Status

<table>
<thead>
<tr>
<th>By Legal Status</th>
<th>2002</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Capital OR</td>
</tr>
<tr>
<td>Single (Sole Proprietorship)</td>
<td>436</td>
<td>428898817</td>
</tr>
<tr>
<td>Limited Liability Company</td>
<td>240</td>
<td>196728027</td>
</tr>
<tr>
<td>Joint Stock Company</td>
<td>66</td>
<td>212323982</td>
</tr>
<tr>
<td>Limited partnership</td>
<td>14</td>
<td>3197360</td>
</tr>
<tr>
<td>General Partnership</td>
<td>29</td>
<td>5941471</td>
</tr>
<tr>
<td>Others such as branch,...</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Under-secretary office, Ministry of Commerce and Industry

3.3.1 Role and Contribution towards Employment and Labour Market:

There are a number of features that could explain labour market structure and challenges in Oman. These include; first, the young and rapidly growing national labour force and the heavy reliance on expatriate labour in the private sector as above 65% of the population is under the age of 25 years. Additionally, the population growth is 3.5% annually. On the other hand, private sector enterprises made little contribution to national employment, which on average constituted 15% of the whole private sector labour market, compare of with 85% for expatriates. Secondly, education policy and a large skill gap between job seekers and the market requirements. According to the World Bank (2008) access to education in the region including Oman has improved. However, quality is deficient with schools unable to help students develop basic and technical skills, creating a skills mismatch between job seekers and the labour market. It is also important to recognize the huge associate of financial cost from remittances which according to the Omani balance of payment accounted in 2011 for $70 billion, the increased pressures on services such as education and health and utilities including electricity and water, and more recently, increased demand from international organizations concerned with

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433 Ministry of National Economy (2010b), Oman census, Oman
434 Statistical year book 2012, Supreme Conical for Planning
435 Educational attainment is raising the aspirations of nationals, but not necessarily their marketable qualifications
labour rights including nationality. Third, government spending packages crowd out the private sector resulting in high dependence for employment of nationals on the government.\textsuperscript{436} In fact, in the government sector the labour force on average is 80% nationals and 20% expatriates. For example recent statistics show that the public sector is the main source of job creation for nationals, in 2012 employing 80% of nationals in Oman.\textsuperscript{437} In most GCC states, for political reasons and to ensure national stability, governments are forced to create a lot of unproductive jobs in the police, defence, national security, and civil services. Young nationals expect to get a job in the government sector sooner or later; and any kind of government job means security, as banks will be ready to extend large loans for car purchase, marriage, and building a house. Overall, this scenario leaves no incentive for them to work hard, pursue a high quality higher education and accept the hard path of private sector employment. When asked in a recent Silatech-Gallup poll whether they would prefer working in the public sector to the private sector or starting a business, between 60 and 80 percent of Gulf youth favoured the public sector.\textsuperscript{438} However, according to the World Bank (2008) neither Governments nor state-owned enterprises will be able to create these public sector jobs in a sustainable manner. The jobs will have to come from the private sector. According to Hartog (2012) number the private sector in the Gulf region has created an enormous number of jobs. However, the majority of these are held by expatriates as they are low-paid and low-productivity.\textsuperscript{439}

\textsuperscript{437} It is estimated that 45% of government spending goes to cover public sector salaries.
\textsuperscript{438} Silatech / Gallup, (2009)
\textsuperscript{439} Government salaries are far higher than in the private sector. Although local people are generally paid better in the private sector than expatriates, but majority remain lower than in the government.
### Table 3.7: Employment 2002/2011

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2011</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Population</td>
<td>2538000</td>
<td>3295000</td>
<td>29.8</td>
</tr>
<tr>
<td>Omani</td>
<td>1870000</td>
<td>2013000</td>
<td>7.6</td>
</tr>
<tr>
<td>Non-Omani</td>
<td>668000</td>
<td>1282000</td>
<td>91.9</td>
</tr>
<tr>
<td>Total Employment</td>
<td>731993</td>
<td>1473471</td>
<td>101.3</td>
</tr>
<tr>
<td>Omani</td>
<td>159106</td>
<td>333699</td>
<td>109.7</td>
</tr>
<tr>
<td>Male</td>
<td>121041</td>
<td>234517</td>
<td>93.8</td>
</tr>
<tr>
<td>Female</td>
<td>38065</td>
<td>99182</td>
<td>160.6</td>
</tr>
<tr>
<td>Non-Omani</td>
<td>572887</td>
<td>1139772</td>
<td>99</td>
</tr>
<tr>
<td>Public Sector Employment</td>
<td>118637</td>
<td>184440</td>
<td>55.5</td>
</tr>
<tr>
<td>Omani</td>
<td>93227</td>
<td>159258</td>
<td>70.8</td>
</tr>
<tr>
<td>Male</td>
<td>67254</td>
<td>94639</td>
<td>40.7</td>
</tr>
<tr>
<td>Female</td>
<td>25973</td>
<td>64619</td>
<td>148.8</td>
</tr>
<tr>
<td>Non-Omani</td>
<td>25410</td>
<td>25182</td>
<td>-0.9</td>
</tr>
<tr>
<td>Private Sector Employment</td>
<td>613356</td>
<td>1289031</td>
<td>110.2</td>
</tr>
<tr>
<td>Omani</td>
<td>65879</td>
<td>174441</td>
<td>164.8</td>
</tr>
<tr>
<td>Male</td>
<td>53787</td>
<td>139878</td>
<td>160.1</td>
</tr>
<tr>
<td>Female</td>
<td>12092</td>
<td>34563</td>
<td>185.8</td>
</tr>
<tr>
<td>Non-Omani</td>
<td>547477</td>
<td>1,114,590</td>
<td>103.6</td>
</tr>
</tbody>
</table>

* Provisional
Source: statistical year book 2012

### 3.3.2 Role and Contribution in Economic Growth:

The Omani future vision for private sectors encompasses three broad goals. Firstly, that the private sector should be characterized by increased efficiency and integration with the global economy. Secondly, that the private sector should be the main source of economic activity.\(^{440}\) Thirdly, that the private sector should be the main source of employment for nationals.\(^{441}\)

\(^{440}\) Such as measured by GDP
\(^{441}\) World Bank (2010), Vision 2020
Despite the vision's goals, and although performance has been improved in recent years, it has still not reached the target level.\textsuperscript{442} In fact, the private sector makes little contribution to the economy in terms of value addition. This is because the public sector plays the dominant role in the hydrocarbon sector, contributing through oil and gas. The GDP growth trend over the years has been largely driven by crude oil prices in the international market. The effects of crude oil prices are also manifested through the inflation rate, employment, investment and saving.\textsuperscript{443}

### 3.3.3 Role and Contribution towards Economic Diversification:

Generally, the degree of economic diversification is reflected by sectoral composition. Omani sectoral composition as shares of the nominal GDP shows mixed results influenced largely by trends in oil prices. Higher oil prices often skew petroleum activity’s share of GDP while minimising the share of non-petroleum activities and vice versa.\textsuperscript{444} Since the beginning of the GCC modern economy, diversification of the economy has taken priority in all plans.\textsuperscript{445} A

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\textsuperscript{442} Mohamed A. Ramady (2012), The GCC Economies Stepping Up To Future Challenges, Springer,  
\textsuperscript{443} Oman Country Profile(2008), The Road Ahead for Oman, Economic Research Forum.  
diversification strategy that can cope with the risks of depletion of oil and gas reserves should emphasize the development of sources of growth and exports that are not dependent on hydrocarbon input, or can still compete internationally when lower costs of domestic inputs are no longer available.\textsuperscript{446} In addition to public investment, structural policy reforms are likely to be crucial to allow private domestic and foreign investment to flourish and naturally develop areas of comparative advantage. Thus policy makers were faced with the challenge of how to transform the structure of the national economy in order to reduce dependence on oil.\textsuperscript{447} The lack of major alternative natural resources other than oil, lack of skilled native manpower and high defence expenditure heighten such challenges. The government have taken important steps to develop the manufacturing sector, enhance the quality of the labour force and increase job opportunities, improve the country’s infrastructure, make the business environment more attractive and stimulate FDI.\textsuperscript{448} Nevertheless, as statistics indicate, although the share of non-oil (tradable) is increasing, its size remains relatively small when compared to the shares of oil, gas and services sectors.

3.3.4 Role and Contribution towards Capital Formation:

It is worth noting that Oman maintains a fixed peg to the US dollar.\textsuperscript{449} In general, the financial sector has a strategic role but is not treated strategically. It is characterized by the following properties:\textsuperscript{450}

- The government is the dominant saver and investor. This is reflected in the relative share of public capital formation in gross capital formation.


\textsuperscript{447} Martin Hvidt (2013), Economic Diversification in GCC Countries: Past Record and Future Trends, Research Paper, Kuwait Programme on Development, Governance and Globalisation in the Gulf States.

\textsuperscript{448} Long-term Development Strategy (1996-2020), Sultanate of Oman, Ministry of National Economy.

\textsuperscript{449} In a small open economy having the peg works as the strongest source of stability, which is so essential for promoting trade and investment in these countries.

\textsuperscript{450} GCC, Secretariat General, Riyadh, (2012).
The various government policies serve to crowd out private savings for example, subsidy and pension systems, that remove any private saving incentive.

Financial institutions do not channel savings in accordance with the needs of productive investment, which is essential in achieving long-term growth, main business lines consumer loans to households.

Private investment is weak; national savings are less than domestic savings due to expatriate labour remittances and interest and dividends paid on external liabilities. The private sector’s contribution to total investment, although increasing over the years, remains the lowest among developing regions.

Commercial banks are among the most profitable institutions in the region.

Due to the limited number of commercial banks and lack of competition, services and policies are not designed according to the market need.

Banks engage in relatively little long-term lending, Project financing is not common in the market.

The SME-specific segments of banking sector are essentially niche products for the banking system; their main business is with salaried households or medium-to-large corporate clients.

Public investment is dominant over private investment. The increase in domestic savings has not necessarily contributed to financial sector development, because private savings remain low.

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451 Steffen Hertog (2010), Benchmarking SME Policies in the GCC: a survey of challenges and opportunities, A research report for the EU-GCC Chamber Forum project.

452 SME-specific segments of banking Banks have limited incentive to engage on the SME side when other options are more profitable and less risky

453 Link with increase in Oil price
• The low private savings rate is unusual in a country with a high-income level when income and saving have a strong positive relationship.\textsuperscript{454}

• Savings incentives are further blunted by a relatively big gap between lending and deposit interest rate.

• Finance and leasing company remained marginal to banks.

• Insurance industries are still small compared to banking in the region.

• Public sector investment accounts for an average of 75\% of total investment.

• Monetary policy structure is inadequate

• Credit distribution among the active sector needs to be incorporated in the new rules of Commercial Banks for future development.

\textsuperscript{454} For example; Private saving rates hovered at 4.8 percent on the average from 2002 to 2008.
3.3.5 State, Business and Society relations in Omani context:

In Oman, the business elite and the ruling families have had a long history of close interactions ever since the pre-oil era, but the oil rent has reversed the balance that existed between the two. With the discovery of oil, the economic structure in Oman changed dramatically from being one solely dominated by business families to one being state-led. Before oil, the relationship between rulers and merchants had the character of a protection racket where business subsidized the rulers, and the rulers in turn protected the merchants' trade. The government did not intervene in the private sector precisely because of their limited capabilities: the merchants had more power and control over the economy than their local political authorities. When oil revenues began to flow into Oman, however, the relationship between the private and public sectors changed, the former being subordinated to the latter in a patron / client relationship.

Governments have eventually come to use the oil rent to protect and boost the private sector. At the same time financial independence provided them with an instrument of influence and control over the business community. While significant rents were recycled to the private sector, merchant elites were asked to behave as loyal allies, and they became dependent on the state to access the distribution circuit. In Oman, the elite business families have been directly involved in the decision-making sphere since the 1970s, notably through holding prominent government positions. Actors within the business community acquired more legitimacy because of the growing state-business alliance: supported by political authorities, they became members of Parliament and board members at the various Chambers of Commerce and Industry.\textsuperscript{455} Since the state crucially needed to adapt its economic policies, the input that these business representatives constituted was highly valued. For this reason, they were able to make policy recommendations at high-level institutions connecting the state to the business community. For example, dealership, subsidize.\textsuperscript{456}

\textsuperscript{455} Valeri, Marc, “State/Business Relations and Labor Market Reforms. The Case Studies of Bahrain and Oman”.
\textsuperscript{456} Valeri, M., Oligarchy vs. Oligarchy: Business and Politics of Reform in Bahrain and Oman, in S. Hertog, G. Luciani and M. Valeri (eds.), Business Politics in the Middle East. London: C. Hurst, pp. 17–4
As one might expect, the business families who have benefited from this relationship have not expressed demands for change. They have essentially used their relationship with ruling families to protect their interests, and hence to exclude potential competitors. The business elite were more concerned with their own economic interests, and their limited political interests which were focused solely on the condition that ruling families should use their political power to stop foreign merchants from competing in the foreign sector. This is a problem because, as Almazini argues, inclusive economic and political institutions will not happen in the gulf region if the protection of the regime is the main priority.\textsuperscript{457} In Oman, many projects appear private but are mostly state controlled. The state has maintained its allocative role, even when expanding the private sector. Major contracts are handed to well-connected people, royals and merchant families. Bablawi’s insights on rentierism in general thus concur with Oman: this strategy of sustaining power undermined sound decision-making and was consequently a barrier to healthy economic development. State institutions remain weak and inconsistent in Oman, where informal personal and tribal networks play a larger role in policy making. While business and public sector leaders frequently change positions, they are not creating continuity in institutional culture. New ministers and director generals bring with them new priorities and institutional cultures. Reliance on personality and family connections decreases productivity and efficiency and can make it more difficult to formulate and implement strategic policy whether related to FDI or other development concerns. This is why in Oman, there are clear signs of inconsistency and incoherence in policymaking.\textsuperscript{458}

\textsuperscript{457} Almezaini, Khalid (2013)

\textsuperscript{458} Competitiveness report
Looking to the governance in Oman, Figure 1.3 provides the percentile rank for Oman on each of six governance indicators. The rankings shown below are for the year 2014. Percentile rank indicates the percentage of countries worldwide that rate below Oman. Thus lower values are associated with bad governance and vice-versa for higher values. These percentile ranks suggest that Oman performs relatively well on Rule of Law and Regulatory Quality, but performs very poorly on Voice and Accountability. Other widely used indicators of governance include the *Global Competitive Index* produced by the World Economic Forum, the *Corruptions Perception Index* produced by Transparency International, the *Index of Economic Freedom* produced by the Heritage Foundation, *Press Freedom Survey* and *Annual Survey of Freedom* by Freedom House, among others.

Figure 3.6: Oman Governance Indicators, 2014

![Percentile Rank Chart](chart)

Historically, none of the structures of modern government in Oman existed prior to the ascension of Sultan Qaboos to power in 1970. Thus, similar to other late developing countries, the first order of business was to consolidate state power rapidly and under difficult circumstances, and to sponsor socio-economic development. Consolidation of state power and socio-economic development were necessary to pave the way for the next stage of transformation: the gradual enfranchisement of the people, the establishment of a bicameral advisory council, a supreme court and other institutions that promote citizen participation and empowerment. The task of steering the country from its medieval state of isolation, stagnation and strife into modernity was a daunting challenge, as the sultanate had neither the physical infrastructure nor an educated population to jump-start socio-economic development.

A variety of institutions are needed to ensure the achievement of growth led by the private sector. These institutions balance and protect the rights of all concerned government parties, private sector firms and society generally. The main role of implementing these institutions is to improve the policy environment in which the private sector operates, encouraging linkages among local firms and particularly MNCs. This would facilitate the transition towards well-functioning markets with competitive and innovative businesses increasing productivity and incomes. In areas where environmental and social conditions are unsatisfactory, a strong institutional system will be a great asset. According to the Bertelsmann Transformation Index (BTI), created by the eponymous German think tank for analysis of political and economic transformation, all GCC states have a BTI index ranging from “limited” to “very limited”. Factors weighing heavily on these slow rates of transformation include corruption and lack of transparency. Indeed, the role of regulatory institutions to ensure proper functioning of private markets is critical, particularly in dealing with protection factor barriers currently in place in labour market and financial sector. All institutions and stakeholders must work closely with each other.
3.4 The Manufacturing Sector Position

Oman's manufacturing sector started in 1975. At that time, Oman met the vast majority of its needs through imports; the target set was for industry to move from import substitution to diversification.\(^{459}\) The manufacturing sector is a key area for achieving this.\(^{460}\) However, the changing of Omani society from being trading-based to becoming industry-based remains challenging, because it is a learning process that involves multiple stakeholder, culture and education. In view of the increasing importance of the manufacturing sector, Oman has in recent years given a major boost to this sector by making conscious efforts to create a conducive business environment. For example, the Omani government established a number of Industrial Estates and created several SOEs to support the sector. In the area of access to finance, Oman has a variety of funding options for investors who are planning to set up manufacturing in Oman.\(^{461}\) In addition, the government are investing heavily in developing free zones with aims to attract more FDI to this sector where the scope of productivity spillovers is huge compared with other sectors. Furthermore, Oman encouraged FDI by removing restrictions in repatriation of capital and income. Furthermore, there is no personal income tax and FDI companies are eligible for a tax break of 5 years, which can be extended to 10 years. The tariff rates are very low making the capital goods and raw material at competitive cost.\(^{462}\)

The vision for Oman’s economy (Oman 2020) seeks to increase the contribution to GDP of non-oil sectors (including manufacturing) to 91%, and to increase the contribution of non-oil exports to GDP to 13% by 2020, as well as enhancing the value added of exported natural resources.\(^{463}\) The ability to achieve such targets must be in doubt unless there is dramatic change in the current trend.\(^{464}\) The Omani government realizes that the manufacturing sector

\(^{459}\) World Bank (2010), Vision 2020 assessment
\(^{461}\) For example, Oman development bank, commercial banks, pension funds and investment companies.
\(^{463}\) Long-term Development Strategy (1996-2020), Sultanate of Oman, Ministry of National Economy
\(^{464}\) World Bank, Vision 2020 assessment
has a huge potential to grow and effectively contribute to diversify the Omani economy, export and generate jobs for a young and growing population.

3.4.1 The Manufacturing Sector contribution to GDP

The degree of economic diversification is reflected by the scope of sectorial composition. Oman’s sectorial composition as shares of the nominal GDP shows mixed results, influenced largely by trends in oil prices. Higher oil prices often skew petroleum activity’s share of GDP while minimizing the share of non-petroleum activities and vice versa. Available statistics disclose that the contribution of non-oil sector to GDP increased from 32% in 1976-80 to 52% in the period 1991-95, and slumped from 50% in 2000 to 47% in 2011. Although the share of non-oil (tradable) is increasing, its size remains relatively small when compared to the shares of the oil, gas and services sectors. According to the targets in Omani Vision 2020 the manufacturing sector should contribute 29 per cent of GDP in 2020. However, as outlined in the Ministry of Commerce and Industry’s annual industrial report 2011, although the manufacturing sector has steadily grown in the last 10 years its average contribution to GDP over the years is far below the vision target; the average contribution for the period 2001 to 2011 was 9 per cent. This makes the Omani manufacturing sector’s average contribution to GDP the lowest among all GCC countries.

3.4.2 The Manufacturing Sector contribution to labour market

Statistically, the manufacturing sector has a limited contribution to the labour market, specifically in job creation for nationals. According to the Centre for Information statistical year book (2012), the concentration of Omanis in the manufacturing sector within the private sector remains low, and the concentration of expatriates in the manufacturing sector remained at just 11.6% in 2011. In raw numbers, expatriate workers in the manufacturing sector totalled 129659 (764 female and 128895 male) contributing 11.6% of the total workers.

465 Central Bank of Oman, annual report 2014
466 Khalfan Al-Barwani, December 2008, Oman Country profile, The Road Ahead for Oman, Economic Research Forum
467 Statistical year book 2012, 3-14
in the private sector in 2011, a sum of 1114590. In fact, one of the major weakness for developing this sector is the lack of expertise and skills as the majority of manufacturing projects undertaken in Oman require specific expertise which are currently unavailable among national labour force.

### 3.4.3 The Manufacturing Sector contribution to export

The non-oil commodity exports of Omani origin increased in value but its share as a percentage of total exports slightly decreased from 17.73% in 2002 to 16.75% in 2011. The same trend applied to re-exports which increased from RO 726.7 million in 2002 to RO 2247.6 million in 2011. However, as a percentage of total exports, the share of re-exports decreased from 16.92% in 2002 to 12.41% in 2011. Looking at manufacturing sector export contributions, as illustrated in Table 3.8, it is clear that this has been growing and has made a good contribution in the diversification of Omani exports. According to the Annual Industrial Report 2011 issued by the Ministry of Commerce and Industry, the major contributors to exports within industrial activity in 2010 were Chemical Products (32%) ; Basic Metals (26%) and Food product and beverages(15%).

**Figure 3.7: Manufacturing Sector Export (RO million)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Exports (RO million)</th>
<th>Total Manufacturing Sector Export (RO million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>4295.6</td>
<td>242.4</td>
</tr>
<tr>
<td>2003</td>
<td>4486.7</td>
<td>335.7</td>
</tr>
<tr>
<td>2004</td>
<td>5144.9</td>
<td>433.2</td>
</tr>
<tr>
<td>2005</td>
<td>7186.9</td>
<td>511.2</td>
</tr>
<tr>
<td>2006</td>
<td>8299.5</td>
<td>644.1</td>
</tr>
<tr>
<td>2007</td>
<td>9493.9</td>
<td>835.2</td>
</tr>
<tr>
<td>2008</td>
<td>14502.9</td>
<td>1259.1</td>
</tr>
<tr>
<td>2009</td>
<td>10632.0</td>
<td>1472.1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>5.6</td>
</tr>
<tr>
<td>2003</td>
<td>7.5</td>
</tr>
<tr>
<td>2004</td>
<td>8.4</td>
</tr>
<tr>
<td>2005</td>
<td>7.1</td>
</tr>
<tr>
<td>2006</td>
<td>7.8</td>
</tr>
<tr>
<td>2007</td>
<td>8.8</td>
</tr>
<tr>
<td>2008</td>
<td>8.7</td>
</tr>
<tr>
<td>2009</td>
<td>13.8</td>
</tr>
<tr>
<td>Avg</td>
<td>9.0</td>
</tr>
</tbody>
</table>

Sources: The Ministry of Commerce and Industry, annual industrial report 2011
Increasing investment either through domestic (public and private investment) or foreign sources contributes to the growth of GDP. In a number of instances, the relative importance of foreign investment is higher given that it is one of the main sources of technology transfer, improvement in management efficiency, and opening up of new markets. The structural policy reforms were crucial in allowing the manufacturing sector to flourish and naturally develop areas of comparative advantage. The government has invested in providing infrastructure like roads, ports, electricity and means of communications etc. Also, the Industrial Estate Authority was formulated in an attempt to accommodate industrial enterprises with adequate infrastructure and services. Furthermore, a number of free trade zones to attract new business and foreign investment were established. These zones can be defined as a labour intensive manufacturing hub, which involves the import of components and raw materials and produced goods mainly for export. Moreover, Oman created numbers of SOEs, with aims to lead the development in manufacturing and provide appropriate platforms for the sector through technology, market information and support domestic manufacturing firms, particularly SMEs. The State continues to play a dominant role in manufacturing; the Government holds a 100% stake in some manufacturing companies, and is an important shareholder in others. In order to attract FDI to Oman, to bring productivity spillovers to domestic manufacturing firms, Oman promotes an open door policy The data presented in the foreign investment survey (2012) by the Centre of Information confirms that manufacturing came second after the oil and gas sectors in attracting FDI. FDI in 2011 was RO 6090.6 million, the Oil and Gas exploration sector was RO 2801.5 million contributing 46% of the total FDI. It was followed by the Manufacturing sector with RO 1257.5 million, contributing 20.6% of total FDI. The greatest investment in Omani manufacturing came from India followed by UAE, US and Netherlands.

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Chapter 4
Research Methodology

This chapter aims to give a description of the procedures that were followed in the research in order to collect the data related to the FDI spillovers and productivity of domestic firms. The rationale for the selection of the research method depends on the research questions and the settings of the study area. According to Blank (1984) a methodology is the way one goes about solving their problems. It includes our points of view and our individual personality in that the way we look at how the world influences our choice of tools to be used in analysing a problem situation. The main purpose of this study is to examine the role of FDI in enhancing the productivity of domestic firms in the case of the manufacturing sector in Oman. The study fills a gap in the literature by analysing Omani data for a period (2002-2013) related to relevant spillover concepts. Thus the study may help other oil producing countries such as GCC countries. The research questions put forward in this study have not been assessed in the Omani literature; thus no data exist that may help answer them. As a result, it was necessary to collect primary data. Also, due to the difficulties associated with studies of spillover effects, the study approached this subject, methodologically, by using a variety of techniques. These fall into two categories: qualitative and quantitative method. This research was based on case study to enable a rich understanding to be gained of the role of FDI in upgrading the private sector. According to Yin (1984, p. 23) case study research excels at bringing us to an understanding of a complex issue or object and can extend experience or add strength to what is already known through previous research.471 Also, Saunders, Lewis and Thornhill (2012, p179), argues that the case study strategy has considerable ability to generate answers to the questions, why?, what? and how?.

The chapter is made up of nine main sections to justify the techniques that have been used to achieve the research objectives and to solve the research questions proposed in this study: The first section presents the research questions and the three research objectives. This is followed by discussions of research methods and instruments and a justification for applying mixed

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methods. The fourth section is an explanation of the pilot study and the fifth discusses the sample, sampling method and sample size. The sixth section provides an explanation of the method of analysis, validity and reliability is discussed, the location of the study in indicated and limitations of the methodology are outlined.

4.1 Philosophical Foundations of the Research

This research examines the role of FDI in enhancing the productivity of domestic manufacturing firms in Oman and the policies required to realise benefits from MNCs. The importance of philosophy is stressed by Avison and Fitzgerald (2003) and Myers (1997)\footnote{Avison, D. and Fitzgerald, G. (2003) Information systems Development: Methodologies, Techniques and Tools. McGraw-Hill Education (UK)} Myers (1997) makes clear that there is considerable variation in the categories and language which researchers use to describe their approach. For example Guba and Lincoln (1994) refer to four underlying paradigms for qualitative research: positivism; post positivism; critical theory and constructivism. However Orlikowski (1991) refer to only three categories: positivist; interpretive; and critical.\footnote{Orlikowski, W.J. (1991) Integrated Information Environment or Matrix of Control? The Contradictory Implications of Information Technology. \textit{Accounting, Management and Information Technologies} (1:1), pp. 9-42.}

4.1.1 The Positivist perspective

According to Lee (1999a), positivism is recognized as the natural science model of research, comprising the rules of formal logic and stressing the role of experimental and the roles of hypothetical-deductive logic. According to Myers (1997) positivist research generally assumes that reality is objectively given and can be described by measurable properties that are independent of the researcher.

4.1.2 The Interpretivist perspective

Silverman (2000) argues that interpretive researchers start out with assumption that access to reality is only through social constructions such as
language, consciousness and shared meaning.\textsuperscript{474} According to Myers (1997) interpretive studies try to understand phenomena through the meaning people assign to them.

### 4.1.3 The Critical perspective

According to Myers (1997) critical research aims not just to understand and explain but also to critique unjust and inequitable conditions from which people require emancipation. Lee (1999) suggests that critical perspectives have a strong vision but that as yet there is limited guidance on how to implement them.\textsuperscript{475} The philosophical foundations of critical research tend to be of an interpretive nature, but with a participative focus.

### 4.2 Research Design

The research design is a crucial factor in determining whether the research will answer the research questions in a satisfactory way. According to Bryman (2008) the research design provides the general framework for the acquisition and analysis of data associated with phenomenon under investigation. There are two fundamental approaches to research, namely deductive and inductive, and each tends to be associated with distinctive techniques of investigation. Deductive research tends to employ quantitative methods that utilise statistical or mathematical models relating to particular questions and measure relationships using statistical techniques.\textsuperscript{476} The quantitative approach can be contrasted with the qualitative which seeks to understand meanings. Inductive research tends to be associated with qualitative methods.

There are a large number of research designs available to researchers, depending on their research problems and objectives. Bryman (2008) suggests five main types of research designs; experimental; longitudinal; comparative; survey and case study.


\textsuperscript{476} Myers, M.D. (1994) A disaster for everyone to see: an interpretive analysis of a failed IS project. \textit{Accounting, Management and Information Technologies} (4:4), pp. 185-201.
The experimental design allows the researcher to investigate the impact of one independent variable on a dependent variable, provided that all other variables which might influence the relationship between the two variables are controlled for. This design is based on a clear-cut theoretical framework and usually focuses on small number of variables. Longitudinal designs, which are traditionally associated with areas of social science such as sociology and social policy, allow the researcher to study the development of specified phenomenon over a certain period of time.

In survey designs, data are collected from several or many cases predominantly by questionnaire or by structured interview, usually with the aims of making generalisations about a particular population. Total survey design (Fowler, 2009)\(^{477}\) involves ensuring the quality of all of the elements of a survey that can affect its accuracy, particularly the sample, the characteristics of those from whom data are collected, the design of questions, and the data collection protocols.

A case study research design is where a single case is investigated in depth. Case studies may be descriptive, exploratory or explanatory (Yin 1994)\(^{478}\). There are differing conceptions of what constitutes a ‘case’ but Johansson (2003:2) argues that the “common denominator that case study researchers (Yin 1994; Merriam 1994; Stake 1995, 1998; Miles & Huberman 1994; Gillham 2001) might agree on would be something along the following lines: The case study should have a “case” which is the object of study. The “case” should be a complex functioning unit, be investigated in its natural context with a multitude of methods, and be contemporary”.\(^{479}\)

This research used a case study design for a number of reasons, and within that case study design, survey, semi-structured interviews and secondary data were combined (i.e. a case study research design using mixed research methods).


\(^{479}\) Johansson Rolf (2003), Case Study Methodology, A key note speech at the International Conference " Methodologies in Housing Research", organised by Royal Institute of technology in cooperation with International Association of people- Environment Studies, Stockholm, 22-24 September 2003
Figure 4.1: Table showing suitability of research designs for different sorts of research questions

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Form of Research Question</th>
<th>Requires Control of Behavioral Events?</th>
<th>Focuses on Contemporary Events?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experiment</td>
<td>how, why?</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey</td>
<td>who, what, where, how many, how much?</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Archival Analysis</td>
<td>who, what, where, how many, how much?</td>
<td>No</td>
<td>Yes/No</td>
</tr>
<tr>
<td>History</td>
<td>how, why?</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Case study</td>
<td>how, why?</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Figure 1.1 Relevant Situations for Different Research Strategies
SOURCE: COSMOS Corporation.

Source: From Yin (1994), p.6

The first reason why a case study design is appropriate is that this research aims to explore opinions and perceptions concerning whether or not policies in one country (Oman) are appropriate for enhancing productivity spillovers from FDI enterprise to domestic manufacturing firms in Oman. The research is to some extent exploratory, therefore and a great strength of case study designs is that they allow the researcher to explore the relationship of phenomenon which may be poorly understood, where there is little previous research or literature. This exploration often centres on a rich description of the phenomenon on which the research focuses in their “real life context when the boundaries between the phenomenon and context are not clear” (Yin, 2009, p. 18).

No research on the research questions of this study has been done in Oman and the researcher had ready access to contacts and networks in Oman which would facilitate the research. Getting access to the relevant stakeholders in other countries might have been very time consuming and difficult, with no guarantee of success. This could be seen as a ‘how’ question in terms of Yin’s table, above (Fig 4.1) in that the research seeks to explore how economic
policies in Oman relate to the facilitation of spillovers from FDI enterprises to domestic manufacturing firms in Oman.

Secondly the research did not require control over behavioural events (as in an experiment) and thirdly the focus was (mainly) on contemporary events (the research requires the collection of information about a number of factors in relation to productivity spillovers in Omani manufacturing sector). These factors are numerous and diversified, including the business environment in Oman and the nature and motive of FDI enterprise although historical context was also relevant.

4.3 Research Methods

It is common to use a combination of research methods within a case study. As Johansson (2003:3) puts it, “One major feature of case study methodology is that different methods are combined with the purpose of illuminating a case from different angles: to triangulate by combining methodologies”. 480

As indicated above, little or no literature is available from Oman’s perspective on both FDI and private sector and there is a shortage of accurate, up to date and reliable statistics regarding the economy. Moreover, there are difficulties associated with studies of spillover effects. For these reasons, and given the complex and in depth nature of this research, in order to obtain the required data the study approached this subject, methodologically, by using a variety of techniques. As Gall, Borg and Gall (1996) explained, both the quantitative and qualitative approaches help researchers make important discoveries, especially when they are used in combination together in the same study, for example, a combination of questionnaires and semi-structured interviews. 481 The present research made use of a combination of quantitative and qualitative approaches in a complementary way. These methods were


selected to overcome any difficulties in terms of data coverage, availability and linkages. These fall into two categories:

4.3.1 Qualitative methods

According to Myers (2009, p 9), “qualitative research is best if you want to study a particular subject in depth and when the particular topic is new and there is not much previously published research on that topic”. The central method used for the research was qualitative; namely, semi-structured interviews. The interviews were conducted with local investors, and foreign investors. Also, a second set of interviews were carried out, with senior Omani officials in relevant government institutes such as the Ministry of Commerce and Industry, Supreme Council for Planning, Investment Authority, Chamber of Commerce and Industry Free Zone Authorities in Duqm, Sohar and Salalah. Common questions were asked across all interviews, but there was great flexibility with respect to the order in which the questions were asked and the researcher followed up on responses which suggested new directions to explore. This allowed for understanding the interviewees' perspectives, rather than imposing preconceived ideas upon their experience and also allows for a rich description of their views and many useful insights which could not have been anticipated before the interview.

4.3.1.1 Selection of particular quotes

The approach used to analyse the qualitative data (which consisted of 42 semi-structured interviews) was thematic analysis, which allows the identification of patterns within the data to be analysed into major groupings (themes). It is a ‘data driven inductive approach’ (Fereday, et al 2006). This study used a mixed methods design and thematic analysis was consistent with that as it does not require allegiance to a particular philosophical paradigm (Braun and Clarke 2006; Fereday, et al 2006).

The approach of Boyzatis (1998) was adopted as a model for carrying out the qualitative data analysis as he seems to offer the clearest description of how to carry out thematic analysis. Boyzatis argues that the development of a code is to some extent determined by what the researcher considers important to the subject being studied.

Boyzatis describes five steps in the development of themes and codes: reducing the raw information, identifying themes from within any subsamples in the data, comparing themes between subsamples, code creation and determining reliability. The research carried out this process iteratively rather than in a simple linear fashion. However, the analysis process used by the researcher did not develop themes within sub-samples as it was not clear that there were any subgroups for which there could be meaningful differences. Unfortunately it was not possible, due to constraints on time, to have the coding process checked for reliability by having another researcher code the data and compare the extent to which there was agreement on the themes developed from the data, as Boyzatis recommends. However, the reliability was ensured by constructing a codebook of the final themes. As per Boyzatis' recommendations each theme was allocated a name (or label), and a description of what content would count as an indicator of the themes.

The researcher read all interview transcripts several times and then coded them into themes, by highlighting relevant sections in the transcripts which seemed to have common meanings. The researcher decided to use an inductive approach where there few a priori categories or assumptions, but also recognised that it was not possible to come to the analysis without any form of preconception; As Braun and Clarke (2006) note, analysis cannot be carried out in an 'epistemological vacuum.' This was especially the case as the survey had been carried out and partly analyzed at the time of the qualitative analysis, and so some ideas of what the themes might be were emerging from the survey analysis although it was not certain that the interview data would generate themes which reflected the survey findings.

The rationale for choosing extracts from interviews are consistent with those described by Corden and Sainsbury (2006). They could be exemplars or
evidence of a theme i.e. a response which was typical of the codes that made up a particular theme. In some cases they demonstrate the range of views or sub themes within each theme, or they may provide an explanation of some phenomenon or the links between some phenomena. The extracts were in some cases selected because they seemed to very clearly summarise the respondents’ own views and so allow respondents to ‘speak in their own voice’. Also, quotes were, in some instances, selected to explain how something happened, or to help understand how an event effected an interviewee. Quotes were also selected to show the ways in which individual people constructed their social reality – what events and opinions of others meant to them. The researcher included enough text in the extracts (verbatim quotes) to enable the reader to understand what the participant meant but not so long as to include irrelevant material. The quotes are intended to be concise and rich with meaning and in some cases are intended to provide evidence for the author’s interpretations.

4.3.1.2 Interpreting the answers

The researcher’s background and familiarity with the culture (Oman) and the sphere of study (economics) helped him to interpret what interviewees were telling him. The researcher has been engaged with the Omani economy for the last 15 years. He worked in the Central Bank of Oman to analyse capital flows in and out of Oman. He also worked in the Ministry of National Economy (MONE), with a focus on promoting Oman as an investment destination and in increasing private sector participation in economic performance. In addition, a significant contribution to gaining insight into the research questions was the researcher’s special appointment as ‘FDI Technical Advisor’ for the International Monetary Fund (IMF) during the course of those years. This position gave the researcher a chance to observe the relationships between FDI and the Omani private sector, understand the culture and the subject, and also maintaining objective distance, critical attitudes, that do not simply take what people were saying at face value. The researcher checked that he had understood what the interviewee had said in their statements by attempting to summaries or condense the interviewee’s statements and allowing them to confirm if this was
indeed what they had meant (Flick 2007). Interviewee’s responses which seemed inconsistent with views or attitudes expressed earlier in the interview were, where possible, questioned and compared to the earlier response. This was not always possible of course due to time constraints and the fact that the researcher may not always recall all the earlier views of the respondent. However, where inconsistencies were picked up at analysis stage (e.g. if an interviewee appeared to have given conflicting account or contradicted themselves in some way) then this is noted in the analysis. The interviewer also considered the structural constrains which were operating on interviewees (e.g. that many were senior managers of commercial forms) and that therefore they might be reluctant to discuss issues which would put their firm in a bad light might discuss these issues but present a false image of their company’s behaviour. The interviewer probed responses which seemed unduly positive, superficial or defensive. However, ultimately it was not the interviewer’s intention to establish some sort of ‘objective troth’ in a positivist sense but rather to fully understand the interviewee’s perspective on the subject matter of the interviews. As Kvale (2013) states, an interview is “a conversation, whose purpose is to gather descriptions of the [life-world] of the interviewee”.

4.3.2 Quantitative method

Quantitative data was collected through a survey of FDI enterprises and domestic enterprises in different economic sectors and locations. This allowed for some generalisations to be made regarding the experiences of these enterprises. The quantitative data allowed comparison to be made on responses to particular questions by certain variables such as the type of ownership of the enterprise and the region.

Secondary data was also collected from various sources covering the period (2002-2011). Smith (2006) suggests that secondary data is used to develop and improve areas where there are gaps in the literature. Secondary data is also useful to obtain the historical background.

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484 The majority were from the manufacturing sector
4.4 Research Instruments

This research aims to get the best quality data collection and analysis based on solid results so using one instrument alone would not fulfill the purpose of this study. Therefore, three instruments were employed, to give more confidence in obtaining the quality of the conclusions obtained as compared to using just one method.\(^{486}\)

4.4.1 The Questionnaire

The questionnaire approach has been used since it is a scientific instrument for the collection and measurement of a particular kind of data. According to Brown(2001, p6), “...any written instruments that present respondents with a series of questions or statements to which they are to react either by writing out their answers or selecting from among existing answers”.\(^{487}\) There are several advantages in the use of the questionnaire as a research instrument. These advantages include:\(^{488}\)

- It provides sufficient time to help respondents think about the questions and answer accurately. The lack of personal contact allows the respondent to feel completely at ease when providing information, particularly if responses are to be anonymous.
- Having specific feedback and response related to research objectives and project knowledge outcomes helps to test hypotheses and get questions answered.
- Data and information can be compared and contrasted after quantifying it to achieve the research objectives.
- Data can be collected in a standardised form, which facilitates statistical analysis and aids comparability.
- Using a questionnaire enables the researcher to gather data from a large number of respondents simultaneously in less time and at less cost than, say, personal interviews.

\(^{486}\) Whyte and Alberti, (1983)  
\(^{488}\) Oppenheim, (1996); Gall, Borg & Gall, (1996); and Cohen, Manion & Morrison (2000)
• Questionnaires can be delivered to very large samples at one time by post, e-mail, and fax or can be administered directly (face to face).

• The use of questionnaires is a central part of social research, as they provide a relatively inexpensive way of discovering the characteristics and beliefs of the population at large.

In contrast, there are a number of potential disadvantages attached to the use of the questionnaire. These disadvantages include:

• If the responses indicate that the wrong questions were asked, or that they were phrased badly, it may be difficult to clarify the information, particularly if the respondents were anonymous. Therefore, the researcher measured the validity of questionnaire, conducted a pilot study and measured the reliability of the questionnaire to make sure that the questionnaire questions were understandable and had a high degree of reliability.

• Postal questionnaires generally have a low response rate. Therefore, the researcher distributed some questionnaires and collected most of them by hand.

• Absence of personal contact with questionnaire respondents makes it difficult to verify the reliability of information and feedback given.

• Questionnaire respondents’ personal understanding and interpretation of questions may bias the quality of answers and feedback.

• Questionnaire cannot probe deeply into respondents' feelings, but this can be overcome by using other instruments, for example interviews in conjunction with other methods. Therefore, the researcher used the interview method in conjunction with the questionnaire method.

Closed questions were used to give specific information about the topic of interest, and they gave a good opportunity to compare answers. This type of question was selected in accordance with the advice of Oppenheim (1996, p114), who suggested these questions are: “easier and quicker to answer; they require no writing, and quantification is straightforward, this often means that more questions can be asked within a given length of time and that more can be

489 Oppenheim, (1996); Gall, Borg & Gall, (1996); and Cohen, Manion & Morrison (2000)
accomplished with a given sum of money.” As this is partly an exploratory study, where it would be difficult to anticipate all the possible answers in a fixed choice format, a final open question allowed the possibility of capturing opinions and experiences, which were not covered in the main body of the questionnaire.

The questionnaire schedule

The questionnaire consisted of five sections.

Section A: aimed to collect general information regarding the respondent’s situation, such as occupation, economic activity, ownership structure and business environment.

Section B: aimed to explain how MNCs influence the upgrading of domestic enterprises through spillover channels and mechanisms.

Section C: aimed to deal with precondition deterrent factors:

a) Absorptive capacity
b) Institutional framework
c) Mode of entry or ownership

Section D: aimed to focus on public policies, strategies and incentives

Section E: called for a SWOT analysis, for the Omani business environment in relation to attracting FDI and formulating business linkages with domestic enterprises.

At the end of the questionnaire, space was provided for respondents to make additional comments about benchmarks or best practices derived from experiences of other countries, which benefitted from FDI to formulate business linkages with domestic enterprises.

4.4.2 The Interviews

The second research instrument was interviews, which are considered to be one of the fundamental data collection techniques as they provide powerful tools to study human beings and how they interact with their world. According to Patton 2002, p.341) “...the fact of the matter is that we cannot observe everything - feeling, thoughts and intentions; we have to ask people questions about those things”491

According to May (1997), there are several types of interview, such as structured interview, semi-structured interview, unstructured interview, and focus groups. This research used semi-structured interviews as its main data collection to solicit respondents’ experience, opinions and knowledge. These interviews were conducted with people from governments, the private sector and MNCs. The interviews were semi-structured, using a schedule developed prior to interviews based on Oman literature and the researcher personal knowledge of the topic, were chosen so as to obtain knowledge on central concepts in order to investigate the questions of this study but also allowing the interviewer the flexibility to respond to topics arising in the interview which were not anticipated and also to respond to questions which the interviewee may ask.492 Another consideration in choosing semi-structured interviews was that the participants in Oman are very busy and would be unlikely to have time for an unstructured interview.

The central focus of the interview was theoretical concepts about the FDI, private sector and other factors that are important for spillovers effects. Furthermore, the interviews captured perceptions of the relations between local and foreign enterprises, which can provide even more valuable information than quantitative investigations, where only a static picture is drawn. With a qualitative approach, it is possible to acquire insights into processes, expectations and perceptions about the relations between domestic and multinational companies in the Omani economy. Therefore, interviews were

492 Social science research uses interviews as a mechanism for in-depth analysis of information that has been collected via questionnaires.
used in this study to validate the questionnaire findings on the one hand and to go deeper to collect additional needed information. According to Kerlinger (1980) the interview can be used in conjunction with other methods in a research undertaking, like a questionnaire, in order to collect more detailed data. The purpose behind that is to validate other methods and to go deeper into the motivations of the sample.

There are several advantages in the use of face to face interview as a research instrument. These advantages include:

- Flexibility: interviewers can seek a more specific answer(s) and can repeat a question when the response indicates that the respondent has misunderstood a question.
- Question order: the interviewer has control over question order; the interview is flexible and adaptable to the individual situation.
- The interviewer can answer questions from the interviewee and can put him or her at ease. This can build up a positive climate for both cooperation and truthfulness.
- Response rate: the interview has a better response rate than a mailed questionnaire. Many persons are willing and therefore provide data more readily and of greater validity in an interview than by filling in a questionnaire. The interview provides an opportunity to question thoroughly certain areas under investigation and allows for a greater depth of response.
- Complex topics can be handled in a controlled environment through questioning and probing techniques to get in-depth details to achieve the research objectives.
- Personal and face-to-face contact with the interviewee enables the researcher to observe the respondents’ feelings and concern on certain questions and important topics.

In contrast, there are a number of potential disadvantages attached to the use of the interview. These disadvantages include:

Researchers need a long period of time to gather data from a large number of respondents simultaneously by means of the interview method. Interviewing is therefore expensive and generally involves smaller numbers of respondents than, for example, a survey. Therefore, the researcher, in the current study, interviewed a small number of respondents (policy makers) and used the survey with a large number of respondents.

Bias can be created if the interviewee is aware of the perspective of the interviewer. Therefore, researchers should take care when designing the schedule and carrying out the interviews not to reveal their personal views on the topics under discussion and should never suggest that there is a ‘correct’ answer or that some answers are more desirable than others.

There is a chance that the interviewer may be unknowingly biased – e.g. that they are unintentionally giving cues to the respondents about what they think of the topic or the interviewee’s responses.

Some interviewees do not like to be taped, because they may be shy, have cultural objections to having their voice recorded, or they may not want their comments on the record, particularly those in more senior positions. This problem can be overcome, however, by being sensitive to the interviewees’ wishes and always carrying a notebook in case taping is refused.

Interviewers need to be very skilful and expert to handle and control the interview so it achieves the objectives of the research project. Sometimes, it is very difficult to keep the interviewee on the right track to get the required data and related information.

**The interview schedule**

The interview schedule in this study consisted of six sections

Section A: aimed to collect general information FDI and business environment in Oman.

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Section B: aimed to explain how MNCs influence the upgrading of domestic enterprises through spillover channels and mechanisms.

Section C: aimed to address preconditional factors: Absorptive capacity, Institutional framework and Mode of entry or ownership

Section D: aimed to focus on public policies, strategies and incentives

Section E: called for a SWOT analysis, for the Omani business environment in relation to attracting FDI and formulating business linkages with domestic enterprises.

At the end of the interview, respondents were invited to make additional comments about benchmarks or best practices derived from experiences of other countries that attract FDI and formulate business linkages with domestic enterprises. (For more details see appendix).

### 4.4.3 Secondary Data

Secondary data\(^{496}\) were used as a third method used to further analyse data that have already been collected to provide additional knowledge, interpretations that in the end contribute to answering the research questions and meet the research objectives.\(^{497}\) Bulmer sums up the chief advantages of existing documentary sources as that they provide a means for triangulating data, of supplementing other methods and of trying to counteract the weaknesses of each method singly by bringing multiple perspectives to bear upon a particular problem. Limitations of secondary data are that they have not been constructive for the purposes of the researcher and so it may be difficult to extract the relevant parts of the data and secondly that the conditions under which the data were collected are not usually fully known, which means that the validity or reliability of secondary data may sometimes be unknown.

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\(^{496}\) According to Punch (1998) secondary data, both historical and contemporary, are a rich source of data for social research.

Multiple sources of secondary data were used to obtain information about the role of FDI in Oman, since some questions could not be answered other than by using secondary sources.\textsuperscript{498} The secondary data used in this research were extracted from official publications of the government of Oman and international organizations. The following data sources in particular were used to examine the hypotheses and answer the questions of this research:

- **FDI Survey** – The analysis on FDI in Oman is based on the results of the foreign investment survey carried out by the Omani Ministry of National Economy (MONE) in collaboration with the Ministry of Commerce and Industry (MOCI), and Central Bank of Oman (CBO) in collecting enterprise data from 2002 to 2013.

- **Production Survey** – MONE conducts a survey of all economic sectors, with the exception of manufacturing, to collect information necessary for calculating variables such as output, intermediate consumption, gross fixed capital formation and value added, which are then used in working out GDP in the National Accounts. The data from this survey and the FDI Survey were linked to establish the contribution of FDI Enterprises to the economy in National Accounts terms such as output and value added.

- **Industrial Statistical Survey** – MOCI conducts a survey of enterprises in the manufacturing sector.

- **Foreign Trade data** – the Directorate General of Customs, Royal Oman Police, records the volume and value of exports. This was used to measure the contribution of FDI Enterprises to exports.

- **Taxation Data** – the Directorate General of Taxation, Ministry of Finance, records turnover for all enterprises submitting tax documents.

- **Balance of Payment (BOP) and International Investment Position (IIP) data** – these data were obtained from the Economic Research and Statistics Department of the Central Bank of Oman.

- **Others** – reports and online resources of UNCTAD, IMF, ESCWA, OECD, WB and other international agencies

\textsuperscript{498} McIvor & Petch (1996) mention that existing documents and statistics can provide a useful resource of data about the process and outcomes of social work.
4.5 The Pilot Study

The importance of pilot testing has been emphasised by many writers such as Avy, Jacobs and Razavieh (1972), Lin (1976), Hayman (1968), Cohen and Manion (1985). Borg and Gall (1983, p30-31) reported, “Every questionnaire must be tested and refined under real world conditions. Even after years of experience, no expert can write a perfect questionnaire.” The pilot test is very important in a research investigation because it helps the researcher to see, for example, how the questionnaires should be administered at the time of the main study and how long it will take to complete them, and to locate any ambiguities, errors or questions that do not work for any reason. On this basis, researchers can remove any items that do not yield usable data, add items to fill any data gaps and reword unclear questions, in preparation for the main study.

The comments provided were incorporated, they included where necessary to improve the quality of the questionnaire and interview.

- Removal of several open questions from the questionnaire
- The importance of tape recording after obtaining permission from the interviewee, as it was realised how difficult it is to take notes and be engaged with the interviewee at the same time.
- Using a support letter to ensure the respondent attention

4.6 The Sampling Method and Sample Size

There are two main types of sampling technique: non-probability and probability samples. In qualitative research many scholars argued that selection for case study need to be based on non-random sampling approaches, such as purposive sampling. Denzin and Lincoln (2000) observe

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500 The difference is that nonprobability sampling does not involve random selection and probability sampling does that mean that nonprobability samples cannot depend upon the rationale of probability theory.

that: “...many qualitative researchers employ purposive, and not random sampling methods. They seek out group, settings and individuals where the processes being studied are most likely to occur”. 502

According to Patton, M. (2002), p46 “The logic and power of purposeful sampling derive from the emphasis on in depth understanding. This leads to selecting information-rich cases of study in depth. Information rich cases are those from which one can learn a great deal about issues of central importance to the purpose of research”. 503 According to Saunders et al. (2007, p 282) “This sampling design which is the most efficient is good choice when differentiated information is needed regarding various strata within the population which are known in differ in their parameters”. 504 Eisenhardt (1989 p.537) in his support of purposive sampling argued that “random selection of cases is neither necessary, nor even preferable” 505

This research was based on purposive sampling (non-probability) techniques, in which sample units are selected based on judgment that they were capable and most readily available to participate in the research, and could provide information that would answer the research questions. 506 A purposive sampling technique was consider appropriate to ensure as high a response rate as possible and to ensure that the research sample was representative, 507 also, because this research aimed to study a phenomenon that is complex and involves different stakeholders including government, domestic and foreign firms. 508 As well as other limitation such as time, money

507 The American Association for Public Opinion Research defines four levels of non-response that can be reported for questionnaires and interviews: Complete refusal (non of questions answered), Break-off (less than 50% of all questions answered), Partial response (50-80% of all questions answered) and Complete response (over 80% of all questions answered)
508 Non-probability sampling can be useful in exploratory research where the aim is to find out if a problem or issue even exists in a quick and inexpensive way.
and workforce, it is almost impossible to randomly sample the entire population and necessary to employ another sampling technique such as purposive sampling.

The literature does not provide clear cut rules with which to determine the number of participants in purposive sampling. However, there have been some broad guidelines, related to situations where the data being collected starts to be repetitive and no new major information emerges ('saturation'). In order to select a scientific sample it is necessary first to identify a suitable sampling frame. In our research the sampling frame was based on the Ministry of Commerce and Industry register at the end of 2012, as it is the most accurate and up-to-date database available. To decide on a suitable sample size, it was necessary to take into consideration the population size. According to Kotler, (2001, p69) “Large samples give more reliable results than small samples. However samples less than 1 percent of a population can be reliable with a credible sampling procedure”.

For the questionnaire, to ensure that the four relevant aspects of category, status, economic sector, and geographical distribution were covered and taking into consideration the large population size in the MOCD registry, the research used non-probability sampling (a purposeful sample) as a sampling technique to obtain a representative sample. This style of logical relationship sampling between selection technique and approach of answering the research questions without giving ample attention to each area might result in biased data collection. Therefore, it is of utmost importance that all arguments must be accounted for towards the final conclusion.

509 Patton, M.Q. (1990), Qualitative Evaluation and Research Methods, London: sage Publication
511 This served to narrow the researcher’s search to a more relevant sample to represent different stakeholders.
The number of participants for interviews was determined by adopting the saturation principle as a guide for the data collection process.\(^{513}\) It has been highlighted that sample size in qualitative studies should generally follow the concept of saturation.\(^{514}\) The saturation principle suggests that the researcher continues collecting data until the collection of new data does not shed any further light on the issue under investigation.\(^{515}\) The selection of the interviewees was based on the snowball technique in which one interviewee nominates another and so on. The first interviewee was drawn from the researcher’s personal network. An information sheet was sent through email to interviewees before the interview took place (For more details see appendix 5).\(^{516}\)

### 4.6.1 Identified and approached participants

At a personal level, the researcher has been engaged with Omani economy for the last 15 years. From 1997 to 2005, researcher worked in the Central Bank of Oman (CBO) dealing with Balance of Payments (BOP) and International Investment Position (IIP), where his main job was to analyse capital flows in and out of Oman. From 2006 to the present, besides, the researcher worked as a planning expert in the Ministry of National Economy (MONE), with a focus on promoting Oman as an investment destination and in increasing private sector participation in economic performance. In January 2007, he was placed in charge of a special foreign investment survey undertaken by the Central Bank of Oman in conjunction with the Ministry of National Economy and the Ministry of Commerce and Industry. All of above assignments and engagements have helped the researcher in networking with all stakeholders, government officials, local and foreign investors. In addition, a significant contribution was researcher’s special appointment as ‘FDI Technical

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\(^{514}\) In the saturation principle, the data collection process through semi-structured interviews continues until the researcher realizes that more interviews do not necessarily lead to more information and the objectives of the study have been also achieved.

\(^{515}\) Mason, (2010)

\(^{516}\) The Information Sheet guidelines follows the KCL Information Sheet template in terms of structure and content.
Advisor’ for the International Monetary Fund (IMF) during the course of those years. This position gave the researcher a chance to observe the relationship between FDI and the Omani private sector. All the above were best utilized for smooth research fieldwork.

The population from whom the sample was drawn comprised businessmen, decision-makers, and local and foreign enterprises. The sample was derived from the four main business areas in Oman, namely, Muscat, Soher, Duqam and Salalah. The selection of sample size was influenced by the following factors:\(^{517}\)

- International agencies such as World Bank and World Economic Forum using only 70 to 80 questionnaires to assess Oman business environment and competitiveness.
- In Oman as in a lot of developing countries the availability of reliable statistic and information is not 100% accrued (World Bank, 2010). Also the culture of the survey and getting opinions is limited and not common.
- Oman is a small economy and the private sector is not well organized compared with the UK and USA. After discussion with concerned parties and scholars from Qaboos University the researcher was advised to cover other economic sectors as Oman has a comparative advantages mainly Oil and Gas, Agriculture and fishery as well as tourism and logistics although the focus would be better on Manufacturing. For this reason the researcher selected 30% of the sample from the mentioned sector to have a better overall understanding.
- According to the result from Establishments censuses for the year 2010, Information center, that the number of profit operating establishments reached (75, 913) in various governorates of which 47% were in the wholesale and retail trade and 20% in the manufacturing sector which was been choice to be the focus of the research(Establishments censuses for the year 2010, p6 and 8)

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\(^{517}\) According to Arber, 1993: 86, the way in which a researcher designs a sample depends on his research objectives. Some researchers select samples in order to provide the maximum theoretical understanding, while others are primarily concerned to obtain a representative sample so that they can make inferences about the whole population.  

• Valid contact information was available for only 70% of the firms
• To ensure the geographical diversification the research carry out the field work in 4 main business area in Oman, namely that Muscat, Soher, Duqm and Salalah. These areas are scattered over 1700 KM
• The weak postal services in Oman,\textsuperscript{518} made approaching all companies difficult.

In the process of distribution of questionnaires or choice of interview participants, the researcher attempted to give a presentation about the research objectives and the potential benefits to the concerned body - Public Establishment for Industrial Estates - in various governorates that deal with local companies and MNCs. The outcomes of this presentation helped to identify the right companies to approach for questionnaire and select the right interviewers who believe they can contribute to answer the research quotations.

\begin{align*}
\text{Total profit operating firms} & \quad 75,913 \\
\text{Manufacturing 20\%} & \quad 15,182 \\
\text{Has valid contact information 70\%} & \quad 10,627 \\
\end{align*}

Consider time, cost and distance
\begin{align*}
\text{The sample} & \quad 150 \\
\text{Manufacturing 70\%} & \quad 105 \\
\text{Other sectors 30\%} & \quad 45 \\
\end{align*}

The interview sample size was composed of:
\begin{align*}
\text{Local enterprises} & \quad 10 \text{ interviewees} \\
\text{Foreign enterprises} & \quad 9 \text{ interviewees} \\
\text{Joint Ventures} & \quad 10 \text{ interviewees} \\
\text{Government official} & \quad 13 \text{ interviewees} \\
\textbf{Total} & \quad \textbf{42 interviewees} \\
\end{align*}

To ensure a good response rate, as well as that the questionnaires were handled by the right person; and that questions were clear to get a feeling about the kind of spillover and interactions between the domestic companies and multinationals players and provide better understanding. The researcher called

\textsuperscript{518} World Bank (2010)
and/or visited all companies’ officials, the researcher stayed for a few days in each area to ensure the report objectives were achieved while communicating to potential participants.

The reaction of the participants was beyond expectation, and the field work was good opportunity for researcher to physically observe and learn the reality. Similarly, there was lot of encouragement and support, like providing useful ideas that enriched the researcher’s knowledge and understanding from the industry, public officials, corporate executives, and policy makers. All this was totally unique along with what was gained in the form of reading materials, books and handbook from training that some participants had attended, such as the one related to Ireland’s experience in attracting and monitoring FDI.

4.6.2 Data Collection and Method of Analysis

According to Yin (1989)\textsuperscript{519} evidence to answering research questions may come from six sources, including: documents, archival records, interviews, direct observation, participant observation. He argued (p, 84) “…some overriding principles are important to any data collection effort in doing case studies. These include use of multiple sources of evidence - that is, evidence from two or more sources, but converging the same of facts or finding”

Patton (2002),\textsuperscript{520} used the term ‘triangulation’ to refer to a combination of different sources in the research of the same phenomena. He argued that triangulation involves comparing some kind of data collected through qualitative methods with some kind of data collected by quantitative methods. The triangulation of data in this study involved questionnaires, interviews and secondary data analysis.

Transcripts of interviews were prepared. Research notebooks and a reflective diary were used to record ideas about the research.\textsuperscript{521} Data was

\textsuperscript{521} Reflective diary in which I noted down what happened and the lessons I learnt, both from things that went well and things that did not gone so well during the research process.
categorized and rearranged into analytical categories online with these were concept and data driven, and were intended to help in revealing patterns within the data to help recognize relationships between categories.\textsuperscript{522} According to Kolb (2008, p. 237) “Once researchers have finished coding for concepts, they may find some need for further breaking down in categories”. The interviews will be analysed by using a coding technique through interpretative analysis. The coding technique is very useful for retrieving and organizing the data into themes in a way that speeds up the process of analysing the data.\textsuperscript{523} According to Sargeant and Jay (2010, p56) “a software package NVIVO allows the researcher to examine and code each aspect of the content”.\textsuperscript{524}

To substantiate the results, the Porter model with the support of a SWOT analysis was used with the objective of gauging how Oman can be an investment destination and how FDI can enhance local firms through spillovers effects. SWOT analysis was carried out to address, FDI and business environment and spillover effects between MNCs and Local companies in Oman. To analyse the secondary data in raw form, this research will utilize a variety of analysis techniques such as graphs, charts and statistics using widely available software such as excel, Statistical Package for Social Sciences (SPSS) and others.

4.7 Ethical issues

Prior to commencing the study, ethical clearance was sought from Kings College London. The researcher addressed ethical concerns and issues as per standard practice. One of the issues for the research was the length of the questionnaires, which may be tiring and influence the validity of the answers, as some of them needed honest and elaborated answers. To overcome this problem a special support/recognition letter from the Supreme Council for Planning in Oman was issued to encourage respondents. To avoid influencing the participants’ answers, as a result of knowing that the researcher working at


a very powerful government institution, the researcher provided an information sheet to all participant to explain the aims of the research and ensure confidentiality, to avoid such issues.

4.8 Validity and Reliability

Seltiz et al (in Bailey, 1982) define the validity of a measuring instrument as "the extent to which differences in scores reflect true differences among individuals on the characteristic that we seek to measure, rather than constant or random errors." May (1997) comments that questionnaires and personal interview are instruments for measuring ideas and for testing hypotheses; therefore, the questions must not only reflect the survey’s aims, but also must be understood by respondents in a clear and unambiguous way. Hence, before applying any test, it is necessary to ensure that it is a valid measurement tool. Therefore, there is a need to check its validity. The term validity is one that is frequently used in the world of research and measurement. “Validity tells us whether the question, item or score measures what it is supposed to measure.” Neuman (2007) added that the validity of a survey is the degree of fit between a construct a researcher uses to describe, theories, or analysis the social world and what actually occurs in the social world. It means truthfulness. It aims to make sure that survey items are clear and understandable, and the conceptual and operational definitions mesh with each other. To measure the validity of this study and confirm the clarity of the items and their relevance to their scales and sections, the following steps were undertaken: The questionnaire form and interview guide were presented to ten specialists in economic development and statistical methods in the Kings College London, the University of London, Sultan Qaboos University, and individuals who are expert in the study area. The purpose of this stage was to make sure that the questions were academically appropriate, clear, and free from repetition. The comments that were provided were incorporated, where

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necessary to improve the quality of the questionnaire and interview. In term of reliability, Litwin defines reliability as “a statistical measure of how reproducible the survey instrument's data are”\textsuperscript{528} In other words, the researcher should expect the same results if he applied the same scale on different occasions or with a different set from an equivalent population. Also, Neuman (2000: 164) mentioned that “reliability means consistency”. It means that the same results would be obtained when the same measure is repeated or recurs under identical or very similar conditions. Oppenheim (1996: 144) emphasised that “reliability refers to the purity and consistency of a measure, to repeatability, to the probability of obtaining the same result again if the measure were to be duplicated”. Hence, the reliability of a measuring instrument is the degree of consistency with which it measures whatever it is measuring. Accordingly, measurement of reliability is a relevant test for measuring the level of similarity in the answers of the sub-sample. There are several ways of testing for reliability such as test re-test, alternative forms and internal consistency. The most suitable type for the current study was internal consistency. The fieldwork took place in the Sultanate of Oman during the second year of the study. Interviews were conducted in public offices or business premises

4.9 Limitations of the Methodology

The research methods were chosen to overcome any difficulties related to data coverage, availability and linkages. The fieldwork was conducted in the Sultanate of Oman where a culture of research is not well established, particularly with domestic enterprises which were one of the most important stakeholders in this study. Another limitation of the survey was the size of the sample (150 companies). Although it is desirable to have as large a sample as possible, the size achieved was ultimately determined by time and budget constraints. Although the survey was limited to Muscat, Soher, Duqam and Salalah, these are the most densely populated areas in Oman and their population is diverse in composition compared to the remainder of the country. In addition, the questionnaire was designed to include additional open-ended

questions calling for explanations that could strengthen the research. However, a low response rate was expected for these questions.
Chapter 5
Quantitative Data Analysis and Findings

The purpose of this chapter is to analyse and present the findings of the survey data which will ultimately answer the research questions. It presents descriptive statistics, in the form of graphs, charts, and tables, to facilitate understanding of the results. It aims to evaluate the productivity spillover effects occurring from MNCs activities in the Omani economy. To achieve this, the quantitative data analysis chapter is divided into five parts. The first part provides an overview of the response rate. The second part discusses the demographic characteristics of the participants. The third part focuses on analysis and findings related to the first aim of the study, regarding examination of spillover effects of FDI on domestic firms by MNCs through various channels that may enable the host market to benefit from the international market and boost productivity in the host economy firms. The fourth part presents the analysis and findings related to the second aim, which was to assess the effectiveness of policy instruments and platforms in the Omani economy in achieving the objectives of productivity spillovers. The final part will provide a summary of all quantitative findings.

As can be seen from figure 5.1, the first 20 items in the questionnaire were designed to gather information in relation to classification of the participants, while questions from 21 to 38 were designed to gather information in relation to productivity spillover channels and mechanisms.

Figure 5.1 : Questionnaire Quantitative Analyses using SPSS components
Questions 39 to 53 were designed to gather information in relation to conditional factors of productivity spillover, while the remaining questionnaire items were designed to gather information in relation to policies and implementation tools which might be needed for productivity enhancement.

5.1 Response Rate

One hundred and fifty questionnaires were initially sent to firms operating in Oman, covering three categories of ownership structure: Omani, foreign and joint venture. These firms were identified with the help of the relevant official body, the Ministry of Commerce and Industry. However, ten firms were found to be no longer in operation. Therefore, 140 questionnaires were considered to be legitimate for this research. Ninety-six useable questionnaires were returned. Eighteen questionnaires were returned that were not considered useable. The unusable surveys were either blank with a note attached which explained why the respondent was not able to complete the questionnaire, or only partially complete, with major portions of the questionnaire blank or with interpretation and alteration. With 114 returned and 18 unusable surveys out of 140, the response rate was 64 percent. Of the 114 questionnaires returned, 34 fully domestic owned firms’ questionnaires were returned, resulting in a 68 percent response rate. Thirty-four foreign owned firms’ questionnaires were returned, resulting in a 68 percent response rate. 46 joint venture firms’ questionnaires were returned, resulting in a 92 percent response rate (see Table 5.1).

<table>
<thead>
<tr>
<th>Ownership Structure</th>
<th>No. of Questionnaires sent</th>
<th>No. of Questionnaires returned</th>
<th>Response rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully domestic owned firms</td>
<td>50</td>
<td>34</td>
<td>68</td>
</tr>
<tr>
<td>Fully foreign owned firms</td>
<td>50</td>
<td>34</td>
<td>68</td>
</tr>
<tr>
<td>Joint venture</td>
<td>50</td>
<td>46</td>
<td>92</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>114</td>
<td>76</td>
</tr>
</tbody>
</table>

The high response rate to the survey can be attributed to several factors falling into two main categories: The first category relates to the willingness of the private sector to cooperate. This is because the private sector (both local and foreign) in Oman relies heavily on the government, particularly in high
demand for goods and services through salaries paid to individuals\textsuperscript{529} and capital expenditures to build infrastructure in various sectors. Furthermore, the government subsidises fuel, gas, electricity, water and land, which provide low-cost input for the private sector. The sector also benefits from low tax and government financial support through ALRAFD and ODP. Although the private sector in Oman is growing significantly, it is important to note that this growth is driven by a number of government support policies which make capital, energy and infrastructure available at low or sometimes no cost.\textsuperscript{530} Indeed, in several economies, government spending can drive business expansion, but business expansion in regular tax-based states also increases government revenue, which in turn allows higher expenditure. However this is not the case in Oman; the causality runs in one direction only. The private sector activities rely on imports and firms pay little tax, which is utilized to provide public services for society as well as income support to jobless locals. Survival of the private sector is primarily dependent on government spending, which in turn is financed by external rents (oil and gas) making it the leading source of business growth. As a result of all the factors mentioned above, the private sector plays a marginal role in forming policy, having low representation and bargaining power.

The second factor which is likely to have influenced the response rate is that the private sector saw an opportunity to send a clear message to the policymakers, particularly as this research was sponsored by the Supreme Council for Planning, which is headed by H.M the Sultan himself and focuses on policy making. It is likely that the private sector respondents saw a real need to address the subject raised in the research and were confident that such research can provide a better understanding of the potential benefits of FDI spillover effects on local companies through transfer of know-how, technology and governance. Also, respondents may have predicted that the research would assist the effectiveness of policy instruments and platforms in Oman and could raise a set of recommendations that can be implemented, given the interest of the Supreme Council for Planning in the Sultanate of Oman. Furthermore, the questionnaire was supported by official letters from the Supreme Council for Planning.

\textsuperscript{529} 85\% of total employment is provided by the government, the current expenditure 29.9 percent of GDP in 2013(CBO,2013, p53)

\textsuperscript{530} Oman Country Profile, The Road Ahead for Oman, Economic Research Forum, December 2008
Planning and from the Public Establishment for Industrial Estates (PEIE) (see attached support letters in Appendix 4). However, this may raise a concern that participants may have been influenced and purposely responded in the way they did to gain benefits or please the government institution sponsoring this research.

5.2 Demographic Characteristics of the Participants

To ensure that the four relevant aspects of category, status, economic sector, and location are covered, the researcher visited all four major economic cities. Figure 5.2 shows the occupation areas of the respondents. Sixty-one per cent of respondents were senior management, 16% of the respondents were technical staff, while 23% of the respondents were in administrative positions. The purpose of asking about occupation was to help the researcher to identify the nature of respondents’ understanding, to obtain different opinions and a variety of information reflecting different experiences and to allow employees in various categories to highlight some obstacles that may prevent smooth productivity spillovers, and thereby reflect strengthen the findings.

Figure 5.2: Occupation of the Respondents

![Occupation of respondents (n=96)]

Figure 5.3 shows the distribution of the responding companies across the major economic sectors. The manufacturing sector is the main focus of this analysis it constituted the majority, with 76%. However, other important sectors were also represented because the Omani economy is a small interlinked economy and knowing the situation in other sectors helped the researcher to
have better understanding about the overall situation and whether there were
differences between sectors in relation to the productivity spillover effects
occurring from the MNCs’ activities. The service sector was second with 16.7
%, followed by the primary sector with just 7.3 %.

**Figure 5.3: Economic Sector of the Respondents**

Data were collected according to the main business location, so that
possible outcome differences between the main locations where the Omani
government has invested heavily to attract FDI into the country could be
investigated. There are three free zones in Oman. The free zones are: Al
Mazunah free zone; strategically located in the south west of Oman on the
Oman-Yemen border, Sohar free zone; a major centre of manufacturing with
low investment and the highest possible added value, and Salalah Free Zone;
located in a globally strategic location in Salalah with access to Europe, Asia,
Africa and Australia. Besides access to the world’s fastest growing markets, the
free zones also offer a host of other business advantages. Duqm Special
Economic Zone is located directly on the Arabian Sea, 500km south of Muscat.
Major components include the second largest dry dock in the Middle East
operated in joint venture with Daewoo and the Government of Oman with an
area of 1,777 km², it is the largest in the Middle East. The data in figure 5.4
illustrates that the majority of respondent companies (70.8%) are operating in
the capital, Muscat. It is worth noting that some of the participants reported that
this was because their head office was in Muscat, while factories were located
in other areas. Salalah provided the second largest proportion of respondents
(11.46%) and Sohar provided the third largest proportion of respondents (10.4%), followed by Duqm with 7.3%.

**Figure 5.4: Location of the Respondents**

Data were collected on the number of years that respondent companies had been in Oman, in order to see whether new and old firms have similar experience of spillovers, or whether there is a direct relationship between the duration of operation in Oman and the spillover effects that occur between MNCs and the domestic companies. From figure 5.5, it is clear that the majority of those who took part in the survey belonged to companies with extensive business experience; those with more than 16 years’ experience accounted for a third (33.3%) of the participants, followed by companies with experience ranging between 11 to 14 years (21.9%). In addition, over one fifth of respondents (21.9%) represented companies with experience ranging from 6 to 10 years, whereas 22.9% came from companies with experience ranging from 0 to 5 years.
One of the items in the questionnaire asked about mode of entry or ownership structure of the enterprises, which can influence linkage formation between MNCs and domestic enterprises. Figure 5.6 highlights that the largest proportion of the companies which responded (40.6%) are partnerships between foreign and local investors, whereas 35.4% of the total respondents belonged to companies fully owned by Omani investors and 24% of companies were fully owned by foreign investors.

5.3 Productivity Spillover Channels and Mechanisms

In order to gather information in relation to productivity spillover channels and mechanisms, respondents were presented with a set of attitudinal statements in the questionnaire and were asked to indicate their agreement or
disagreement with the given statements through the use of a five-point Likert scale, where 1 represented strong disagreement and 5 indicated strong agreement.

Table 5.2: Factors which were considered important for FDI in Oman

<table>
<thead>
<tr>
<th>Factors</th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>Mode</th>
<th>Range</th>
<th>Minimum/Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilizing quality infrastructures</td>
<td>96</td>
<td>4.22</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Utilizing local location</td>
<td>96</td>
<td>4.21</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Expanding market</td>
<td>96</td>
<td>4.2</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Capitalizing on tax incentives</td>
<td>96</td>
<td>4.05</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Securing raw material</td>
<td>96</td>
<td>3.84</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Collecting market information</td>
<td>96</td>
<td>3.79</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Following major clients</td>
<td>96</td>
<td>3.7</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
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<tr>
<td>Investing with other in same industry</td>
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<tr>
<td>Accessing cheap labour</td>
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<td>3.36</td>
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</tbody>
</table>

* Table of descriptive statistics, derived from a Likert scale with values ranking from 1 (strongly disagree) to 5 (strongly agree)

At the start of the questionnaire respondents were asked about factors that might be considered important for FDI in Oman. The responses are shown in Table 5.2 above (descriptive statistics) and figure 5.7 (below) as percentages. As can be seen from Table 5.2 in general terms respondents considered that all of the factors offered in the questionnaire were important – no item scored lower than a mean of 3.36 on the scale of 1 (strongly disagree) to 5 (strongly agree). Although the majority of respondents gave positive (agree and strongly agree) responses to the suggested factors, there was considerable variation in the levels of agreement. As can be seen from table 5.2, utilizing a quality infrastructure has the highest mean (4.22) and were therefore considered the most important factor; 36.5% of respondents strongly agreed and 54% agreed on the salience of this factor. The government has continued investing heavily in upgrading infrastructure. As was explained throughout all five -year development plans have been characterized by high investment in much needed infrastructure according. The striking observation to emerge from the data in Table 5.2 was that securing raw material ranked fifth among factors considered important for FDI. Although Oman is rich in many natural resources,
such as oil and gas, minerals, fisheries, tourism, and others, nevertheless, acknowledgment of there was lower than might be expected. This may be due to the lack of marketing activities by relevant institutions. That being said, it is important to consider relative and absolute differences in mean.

Figure 5.7: Factors considered for FDI in Oman

Factors considered important for Foreign Direct Investment (FDI) in Oman (n=96)

- Utilizing quality infrastructures
- Acquiring key or new technologies
- Capitalizing on tax incentives
- Collecting market information
- Expanding market
- Investing with other in same industry
- Following major clients
- Accessing cheap labour
- Utilizing local location
- Securing raw materials

Figure 5.8: Is Oman a suitable place for Foreign Direct Investment?

Attitudes to statement “Oman is a suitable place for foreign direct investment” (n=96)
The figure above presents the respondents’ perceptions on whether Oman is a suitable place for FDI. Overall, there was a positive perception, with a mean score of 4.19; 22.9% of respondents agreed strongly and 74% agreed that Oman is a suitable place for FDI. This supports the recent statement by UNCTD that Oman is not fulfilling its potential in attraction of FDI, it could attract a far greater volume of inward FDI flows considering all its strength, resources and unique features.\(^{531}\) There was some variation in levels of agreement, by ownership structure, mainly in that fully foreign-owned companies were much less likely to say ‘strongly agree’ (8.7%) than were respondents representing companies with other types of ownership structure. It might be argued that these respondents are better able to say whether Oman is a suitable place for FDI than either joint venture or Omani-owned companies, as they are the ones making the FDI. However, we should recognise that even amongst the FDI group of respondents, there may be bias towards agreement with the statement because those that do not see Oman as a suitable place for FDI would not come to Oman, or may have left, so would not be captured in the survey.

**Figure 5.9: Do MNCs have any form of business arrangements with domestic enterprise?**

\(^{531}\) World Bank (2013), Doing Business Report, the World Bank, Washington D. C.
Table 5.3: MNCs business arrangements with domestic enterprise

<table>
<thead>
<tr>
<th></th>
<th>N</th>
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<th>Mode</th>
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</table>

Table of descriptive statistics, Likert scale from 1 (strongly disagree) to 5 (strongly agree)

An observation to emerge from figure 5.9 is that the majority of respondents (95.1%) expressed positive attitudes (agree or strongly agree) to the statement regarding whether MNCs have any form of business arrangements with domestic enterprise. In this regard the mean was 4.2, reflecting that 67% of the participants agreed, and 28.1% agreed strongly, as compared with only 2.1% who gave neutral responses, 1% who disagreed and 1% who disagreed strongly. Participants explained their answers saying that MNCs purchase materials and services from local companies and vice versa, appointing local distributors. Similarly, raw and packaging material, services like testing civil work and maintenance are sourced locally. The few participants who disagreed with the statement believed that local suppliers and distributors do not keep a suitable and comprehensive stock of materials, on the assumption that if they receive an order, they can source the required materials from Dubai or India within one week. Overall, although some initiatives are being taken, the outcomes were said to be limited. When participants were invited to explain how MNCs influence upgrading of domestic manufacturing enterprises in Oman, responses included that MNCs pass on the latest technology and quality standards, proven HR development plans, IT systems, technical know-how, applying safety procedure, experienced supply chain management, setting work standards, access to other markets, training of manpower, a proven track record, team working newer skills, latest manufacturing technologies, and the latest management techniques which domestic enterprises are forced to follow.
Table 5.4: Business Linkages

<table>
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<td>4.00</td>
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Table of descriptive statistics for variables 20-29 (Business linkages). Ranked on mean (descending order). Likert scale from 1 (strongly disagree) to 5 (strongly agree)

All the above mentioned spillover effects of FDI on the domestic firms, such as new technology, marketing techniques, management skills, capital, employment, export enhancement, diversification of economy and increased competition, result in improved efficiency of domestic market and boost productivity in the host economy firms. These potential effects are transmitted through a variety of mechanisms, which include business linkages, competition, labour mobility, and demonstration effects.

5.4 Methods and Mechanisms of FDI Spillover Effects

5.4.1 Business linkages

Business linkages are a main channel for productivity spillovers from MNCs to domestic enterprises, as MNCs can help the domestic enterprises through the backward and forward linkages they generate through market
transactions. As can be seen from Table 5.4 and Figure 5.10, skill spillover received the highest mean agreement (5.4) and was considered the most important form of spillover from MNCs to domestics companies; 45.8% of respondents strongly agreed and 49% agreed that this factor was important. The second most important form of business linkage was technology spillovers (mean of 4.3) where 36.5% strongly agreed and 61% agreed. This was followed by marketing techniques (mean 4.2), where 41.7% answered strongly agree and 51% answered agree.

**Figure 5.10 : Business Linkages**

As illustrated in Table 5.4 and Figure 5.10, indirect linkages with local competitors through demonstration effect and labour mobility, with a mean of 3.98 was considered a common form of business linkages; 11.5% of respondents strongly agreed and 77% agreed. The second form of business linkages was direct forward linkages with local agents and/or customers for marketing, distribution, or supply of inputs or other assistance for improvement (mean 4.3) where 11.5 % answered strongly agree and 74 % said they agreed.
5.4.2 Competition

Most respondents agreed that MNCs compete with domestic enterprises; 15.6% of respondents reporting that they strongly agreed and 54.2% reporting that they agreed. However, there were differences in levels of agreement according to the ownership structure. As can be seen from Figure 5.12, enterprises fully owned by Omanis showed the highest agreement; 17.6% of respondents strongly agreed and 67.6% agreed. Second in agreement were enterprises fully owned by foreigners, where 21.7% agreed strongly and 47.8% agreed.

Table 5.5: Do MNCs compete with domestic enterprises?

<table>
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<th>Mode</th>
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</tr>
</tbody>
</table>

Table of descriptive statistics, Likert scale from 1 (strongly disagree) to 5 (strongly agree)

Figure 5.11: Do MNCs compete with domestic enterprise?
5.4.3 Demonstration effect

With regard to demonstration effect, the second channel for productivity spillover, figure 5.12 shows that 11.5% of respondents strongly agreed and 75% agreed that domestic enterprises learn through observation and imitate the multinational companies by adopting their new technologies, marketing techniques, and types of products according to the local conditions. Also, 38.5% strongly agreed and 45.5% agreed that effort is being made by domestic enterprises in terms of demonstrating new technologies and training workers in order to master the new technology.

Figure 5.12: Demonstration Effect

5.4.4 Labour Mobility

The third channel for productivity spillover is labour mobility, which occurs when MNCs provide training, and work experience to local workers who then move and apply their knowledge. As can be seen from Table 5.6 and Figure 5.13 agreement that there is movement of workers from domestic enterprises to MNCs had the highest mean (3.98); 19.8% of respondents strongly agreed and 64.4% agreed with this item. This finding is consistent with major trends in the Omani labour market. Oman has a population of 3.6 million (of whom 1.53 million are non-national) but the private sector workforce is predominately foreign and according to official statistics, only about a third of employed
Omanis are in the private sector, which means that the majority of national human resource is tied to the government. Low salaries and benefits help explain the low desirability of employment in the private sector, although the minimum monthly wage was raised in 2011 from OR 140 to OR 200 ($364 to $520) and again in 2013 to OR 325 ($844). The item with the second highest level of agreement was “MNCs provide a type of in-plant training programme for managers and technicians working in the same enterprises” (mean 3.97) where 14.6% strongly agreed and 40.6% agreed.

Table 5.6: Labour Mobility

<table>
<thead>
<tr>
<th>N</th>
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<th>Mode</th>
<th>Range</th>
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<td>Movements of workers from domestic enterprises to MNCs</td>
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<td>MNCs do provide a type of in-plant training programme</td>
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<td>MNCs do assist the domestic enterprises in terms of types of training</td>
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<td>MNCs provide a type of in-plant training</td>
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<td>Movements of workers from MNCs to domestically owned enterprises</td>
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Table of descriptive statistics, Likert scale from 1 (strongly disagree) to 5 (strongly agree)

5.6 Preconditional Factors for Productivity Spillovers

As productivity spillovers do not happen naturally, understanding the prerequisite factors for productivity spillovers in the context of the Omani manufacturing sector was among the purposes of the research. The participants were therefore asked to rate their level of satisfaction with the quality of preconditional factors. The answers were negative, reflecting a low level of satisfaction concerning these factors. As can be seen from Figure 5.14 and Table 5.7, levels of satisfaction overall were moderate or low. Local human resources had the highest mean satisfaction (3.19) but only 4.2% of respondents claimed to be very highly satisfied and 27% reported being satisfied. This indicates a major weakness in the Omani context, as low levels of education, or not having the right skills, limit the employment for which Omanis are competitive. This situation is not unique to Oman and is arguably applicable to all Gulf countries and other oil producing countries characterized by small populations. That being said, this problem has a direct negative impact on productivity spillovers from MNCs to domestic companies, which require Omani human resources to play an important role. The item with the second highest mean satisfaction was infrastructure (mean 3.07) where 9.4% of
respondents were very high satisfied and 30.2% satisfied. This was expected because the government is investing heavily in this area. It appears from the statistic that Institutions and domestic enterprises have the lowest level degree of satisfaction.

Table 5.7: Preconditional factors

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</table>

Table of descriptive statistics, (1: very low, 5: very high)

Figure 5.14: Preconditioned factors and level of satisfaction

Respondents were asked which factors they think are key determinants of spillover from MNCs, which may influence linkage formation in the context of Oman manufacturing sector, with particular reference to absorptive capacity which include Institution framework, human resources, property right and level of technology. Available statistics and official reports confirm that there is a
shortage of absorptive capacity in the country, particularly in terms of needed institutions to drive private sector led growth, not in terms of quantity but quality. Also, technical and managerial skills are needed to drive this transformation and private sector competitiveness. The quality of current institutions should be enhanced and new institutions created to build linkages and scale up success stories e.g. local content and in country value program. As shown in Table 5.7 and Figure 5.15 institutional framework has the highest mean (4.41) and was considered most important factor for spillovers. 50% of respondents strongly agreed and 43.8% agreed on the importance of this item. The second most important factor was Human Capital (mean 3.92) where 18.8% strongly agreed and 62.5% agreed. Increasing labour productivity is essential to benefit from existing MNCs and complement the role of capital investment in fostering growth. In this respect, continued efforts to improve education and provide students with skills required in the marketplace would prove valuable. The third most important factor for spillovers was property rights (mean 3.86) where 12.5% answered strongly agreed and 65.6% agreed that it was important. Research and development was rated fourth most important (mean 3.64) where 16.7% answered strongly agreed and 46.9% answered agree.

Table 5.8: Key factors for Spillovers

<table>
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<tr>
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Descriptive statistics. (Sorted descending on mean – items at top of table had highest importance in influence linkage formation)

533 There are numerous bodies, and programmes in place, but working in a conflicting way
5.7 Effectiveness of Policy Instruments

The most interesting finding concerned the effectiveness of policy instruments and platforms. Taking into consideration that spillovers from MNCs do not happen naturally, the question was raised, what kind of institutional conditions affect successful spillovers and whether there are any public institutions in place in Oman that ensure and encourage spillovers between MNCs and domestic enterprises.

The results show that the majority of respondents reported that there is no institution that ensures or encourages spillovers between MNCs and domestic enterprises in Oman, although such an institution is highly needed and recommended to enhance the spillovers. However, the participants who responded yes to this question identified different names such as the Ministry of Commerce and Industry, the Public Authority for Investment Promotion and Export Develop (PAIED), the Supreme Council, and the Authority of Industrial State which indicates a lack of agreement among the respondents who answered yes on the institutional body with a mandate for spillovers. In addition, the respondents emphasised the importance of having a public institution in place that can ensure and encourage spillovers between MNCs and domestic enterprises, as spillovers do not occur naturally.
Questions were posed about which mode of entry or ownership structure of MNCs creates greater benefits and influences linkage formation with domestic enterprises. The majority of respondents, across all three modes of ownership\textsuperscript{534} indicated that to enhance productivity spillovers, joint venture is recommended to be the best option.

Respondents were asked about which aspects of policy influence the way firms operates in Oman in relation to the spillovers effects. As can be seen from

\textsuperscript{534} fully owned by Omani, fully foreign owned and Joint Venture
Table 5.8 and Figure 5.18, local contents or country value requirement has the highest mean (4.14) and was considered most important policy that may affect spillovers, 33.7% of respondents strongly agreed and 49.5% agreed on this item. The second policy was the Omanization requirement (mean 3.98) where 32.3% strongly agreed and 43.8% agreed that this policy was important for spillovers.

**Figure 5.18 Aspect of policy influences the way your firm operates in Oman**

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<tr>
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</table>

(Sorted descending on mean – items at top of table had highest level of satisfaction)
With regard to what motivates MNCs to invest in Oman, Figure 5.19 and Table 5.9 show that market seeking has the highest mean (4.03) and was considered the most important motive to invest in Oman (29.9% of respondents strongly agreed and 50% agreed on this item). This finding invites policymakers in Oman to improve Oman’s connectivity with its neighbours in Gulf countries and emerging markets such India and China, which can open a gate for investors who want to locate in Oman to serve this market.

The second most important motive for MNCs to invest in Oman was resource seeking (mean 3.85) where 14.6% strongly agreed and 66.7% agreed. This finding is consistent with the reality that Oman is blessed with abundant national resources which open opportunities for investors. However, so far there is limited utilisation of the available natural resources other than hydrocarbons and the contribution of the traditional sector (agricultural and fisheries) to gross domestic product is low.

**Figure 5.19: Motive for investment in Oman**
Table 5.10: Motive for investing in Oman

<table>
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(Sorted descending on mean – items at top of table had highest level of agreement)

Participants were asked about whether there are other policies/strategies that can enhance spillovers from MNCs to domestic enterprises. As can be seen in Figure 5.20, 10.4% of respondents reported that they strongly agreed and 49% reported that they agreed. On attracting skilled personnel to move from domestic enterprises to MNCs, 12.5% agreed strongly and 32.3% agreed. As for strategy to release skilled people from MNCs to work at domestic enterprises, 7.3% agreed strongly and 60.4% agreed.

Figure 5.20: Incentive structure
Table 5.11: Incentive structure

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Sorted descending on mean – items at top of table had highest level of agreement

Respondents were asked about forms of interaction between MNCs and domestic enterprises. As can be seen from Table 5.11 and Figure 5.21, the quality systems has the highest mean (4.09) and was considered the most important form of interaction 16.7% of respondents strongly agreed and 78.1% agreed on this item. The second interaction item was After-Sales services (mean 4.08), which 19.8% strongly agreed, and 69.8% agreed was a form of interaction between MNCs and domestic enterprises.

Figure 5.21: Do MNCs interact with domestic enterprises?
Table 5.12: Do MNCs interact with domestic enterprises?

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Sorted descending on mean – items at top of table had highest level of agreement

5.8 Chapter Summary

Understanding and addressing the productivity spillovers from MNCs to domestic manufacturing companies requires an in-depth analysis because it is a multi-sector challenge and will not happen naturally; it needs to be managed.

In terms of the first objective, addressing spillover effects of FDI, the current data presented in this chapter show a clear positive impact- although slow progress- on overall Omani economic development, including productivity spillovers that contribute in upgrading and enhancing the performance of domestic firms through interaction with MNCs operations. However, the scope of the spillovers is limited, which could be attributable to the weak absorptive capacity in the Omani economy, particularly with local human resource not having the necessary level of skills and being less motivated to work in the private sector. In addition and equally important are the passive role of the government and lack of functional institutions to lead the productivity spillovers agenda. The second objective concerned institution and policy platforms as institutions affect policies, and policies affect multinational operations. In general, the majority of respondents acknowledged that the government has an essential role to play in achieving productivity spillover objectives. It also shapes MNCs’ activities, through strengthening the absorptive capacity of the private sector and applying needed policies to influence the operations of MNCs, such as domestic content requirements, ownership structure, investment promotion
and export performance requirements. Furthermore, the majority of respondents reported that there is a need for a government institution that focuses directly on attracting FDI and ensures spillovers effects from MNCs to domestic firms, as no such institution currently exists and this mandate is scattered among several bodies, without any one being accountable for the spillovers agenda. In terms of mode of entry or ownership structure, the majority of respondents indicated that to enhance productivity spillovers joint venture (JV) is recommended to be the best option. This is due to the fact that this form of ownership achieves mutual benefits. It benefits local investors by expansion of operations, new skills and reaching new markets. Also, joint ventures benefit the foreign investor, who gains knowledge of the local market and secures local commitment and interest. In fact, there is a need for a new agenda of policies toward FDI that will maximize the benefits that can enhance the economic development process. These are related to employment, investment, diversification and exports, in addition to the benefits related to enhancing the productivity of the local firms, which are the focus of this study. This requires specific policies, which may include domestic content requirement, export performance requirement, local human development requirement and business linkages between MNCs and domestic firms.
This chapter will discuss the qualitative data from the study, which is based on the data collected through interviews with key stakeholders regarding productivity spillover from MNCs to Omani manufacturing firms. The interviewees were policy makers in the government, local investors and foreign investors, to explore the role of FDI in improving productivity of manufacturing firms in Oman. The chapter comprises the following sections: the first section analyses the results of the semi-structured interviews and begins by exploring the interviewees' opinions about FDI, particularly its impact on domestic firms. This is followed by an analysis of the interviewees' views on the effects and policies needed to facilitate productivity spillover. The next section will shed light on the findings of the Omani business environment in relation to attracting FDI and formulating business linkages with domestic enterprises through the use of SWOT analysis. The last section will provide a summary of the chapter.

To explore the phenomena under investigation, the researcher engaged in substantial fieldwork in 2013, carrying out face to face interviews with 42 representatives from the three categories of firms mentioned above. Before interviews started the initiation of the research study, the significance, rationale and purpose of the study were explained to interviewees. The interviewees were assured that all the data they gave would be used for the research purposes only. Digitally recorded and hand written notes were taken at each interview. The interviews were conducted between June and September 2013, and ranged from 30 to 70 minutes average length. The core question of the interviews was, ‘To what extent has FDI been successful in enhancing the productivity of domestic manufacturing firms in Oman?’: This was followed up with two further questions.

The first question aimed to examine the role of FDI in enhancing the productivity spillover: How has FDI affected the productivity of domestic firms in the manufacturing sector in Oman? And what are the specific factors to be considered in enhancing productivity spillovers?
The second question aimed to examine the effectiveness of policy instruments and programmes those to do with FDI spillover: Have current policy instruments resulted in enhanced productivity spillovers? And which policies should Oman learn from and adopt to capture the benefits from FDI and avoid the negative impact?

The sampling strategy for the interviewees in this research was purposive rather than random. The reason for choosing purposive sampling is that the research questions focus on the impact of FDI in enhancing the productivity of the domestic manufacturing firms and it was considered therefore that it would be most useful for addressing the research questions to interview individuals who were likely to have an informed opinion on this subject. A complete list of interviewees along with their positions, their organizations, and the total number of years of experience are listed in Appendix no 5.

6.1 Business Environment and FDI Impact on the Domestic Firms

In terms of the overall business environment, most respondents felt that Oman had a good, welcoming, business-friendly environment, and a lot of interviewees, particularly in the foreign investor category, confirmed that Oman had a huge potential for FDI. However, several respondents felt that Oman was not able to attract more FDI, and this was attributed to several reasons, including weakness in the area of marketing and implementation of policies announced by the government. Others respondents added that the small size of the private sector, along with its limited absorptive capacity, played a significant role in that slow progress, both in terms of attracting FDI and in utilizing it to further benefit the private sector. This was expressed in the following statements:

‘Oman has many incentives that make it a hub of FDI - for example we have very good infrastructure, we have attractive regulations for investments. Also Oman has many natural resources that make it an attractive place to invest’. (IO33)\(^{535}\)

‘Oman’s success in attracting FDI has been modest when compared to certain countries in the region. The reasons for the modest inward FDI could be attributed to the inadequate priority given by the policy makers’. (IO43)\(^{536}\)

\(^{535}\) Interview with an official, Director General of Nizwa Industrial Estate

\(^{536}\)
‘The FDI per se has been good. I cannot say it has been excellent...so in terms of its success it’s let say ...moderate to good...it’s not yet excellent... because there are still things to be done’ (IO42)

Interviewees were asked also, about their views about the importance of FDI to the Omani economy, particularly the role of FDI in enhancing productivity spillovers in Omani manufacturing firms, the central question for this research. The majority of interviewees acknowledged that FDI played an important role, on both macro and micro levels, particularly in private sector development. This was clear in the following statement made by a local investor:

‘Of course FDI is very important because it helps Omani companies to increase export and to look at the foreign export. It is very important for industry because most of the industrials in Oman, I will say 80% of the companies in Oman export out of the region and FDI helps Omani products to reach all around the world’. (ID11)

Another stated that:

‘I think that the FDI can help us in many ways through learning, how to manufacture, how to control the companies, how to export, how to do many things, FDI companies which come to Oman have a lot of experience of how to control the companies, how to manage and this is what we need’. (ID41)

Others said:

‘We learned a lot from foreign companies, we learned about marketing, sales, how to even approach new countries and how to develop products and how to price them, how to even, increase the efficiency of workers, how to do many things’. (ID27)

‘Yes, I have an example of how a foreign company influenced us as a domestic enterprise and helped us to export to the US market and we learned a lot and I think it changed us for the better and enabled us to enter the international market’. (ID11)

This matter was brought up also, by some foreign investors, who stated:

‘We see developing local capacity as a journey to stay on the all-way of doing business within Oman. We do not execute any activities. We manage local businesses and help to develop the capabilities to international standards’. (JV19)

536 Interview with an official, Senior Economist in the Central Bank of Oman
537 Interview with an official, CEO Freezone Sohar (SFZ)
538 Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
539 Interview with domestic manufacturing firms in Muscat, Chief Financial Officer in Oman Fiber Optic Co. S.A.O.G
540 Interview with domestic manufacturing firms in Salalah, Managing Director in Oman Industry
541 Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
542 Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel
Another foreign investor said:

‘FDI gives opportunity for the local business to blend with the foreign elements of technology, the foreign elements of management resources because there is a cross exchange of management, there is a cross exchange of technology. So all of these opportunities give the local enterprises and local business a chance to improve their performance and then this blend creates a definite platform for further improvements’. (IF5)  

Two other respondents felt that:

‘FDI as an avenue can bring in new technology, it can bring in management expertise. It can make available the funds that are required to support the enterprises, so in all of these areas, definitely there is a contribution by the FDI to enhance the performance and opportunities for local business.’ (IJV36)  

‘bringing the brand to Oman, creating jobs, bringing expertise, bringing the management style,… foreign players bringing the standards, for example ISO 9000 or 9001, 14000, 21000 all these standards, which lead to excellence.’ (IF12)  

This point was also strongly supported by some official interviewees, as emerged from the following quotations:

‘We cannot get the know-how through the universities or schools. People like to get that experience through the skills from the reality, from business to business and it’s not happening till we have that relationship between foreign investments and local investment here in Oman’. (IO23)  

‘Yes of course FDI is important to Oman. Because if you look at our GDP, say in the 1970s the 1980s and 1990s, and compare it to our GDP now, you see there is a huge jump and that jump has been helped by the investments’. (IO42)  

‘FDI increased the human resource capacity through training, interacting with new technology also increased the efficiency of production by knowing new ways of, you know, technologies and also associating with international companies. That will result in knowing the international market, establishing new relationships with international names and, having the knowledge of knowing the international market. It will help to cut the cost of projects and also to become more competitive in the international market’. (IO7)  

Likewise, interviews with some companies involved in joint ventures stressed the point by stating:

543 Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC  
544 Interview with foreign manufacturing firms in Muscat, Managing Director in Safety industry  
545 Interview with foreign tourism firms in Duqm, General Manager in Crowne Plaza Duqm  
546 Interview with an official, Director of Media & Communication in Public Establishment for Industrial Estates  
547 Interview with an official, CEO Freezone Sohar (SFZ)  
548 Interview with an official, Director General, Investment Promotion, in Public Authority for investment Promotion & Export Development
‘Foreign investment can be put into further improving the infrastructure which will facilitate the people and it will bring in better technology, skills will be developed and obviously the export potential, furthermore, can be tapped’. (JV13)549

‘Absolutely, there are lot of positives that are coming deriving from having FDI, improving or introducing capability to manufacture something, job opportunities and sending a product outside Oman’. (JV18)550

‘If I assume Shell is behind PDO and PDO says you have to have these policies these procedures for Health and Safety then the contractor, sub-contractor, sub-subcontractor all of them have to comply’. (JV18)

However, some respondents felt that Oman was still not able to benefit from FDI:

‘FDI has yet to make a notable impact in Oman because the country experienced little economic pressure for a number of years to focus on FDI. However, recent years have witnessed a policy shift towards promoting FDI in Oman’. (IO43)551

Overall, it appears that the majority of interviewees agreed that the business environment can attract FDI and manage it such a way as to benefit the domestic economy particularly domestic enterprises. However, a lot of them acknowledged that more can be done.

Basically the finding related to the sound business environment is in line with World Bank 2010 report, assessing the Omani economy, and recent paper published by Chatham House.

6.2 How Productivity Spillovers Materialise

This theme concerns better understanding about how productivity spillovers materialize and what are the main mechanisms that could suit the Omani context among all known mechanisms highlighted in the literature, which include business linkages, demonstration effects, labour mobility and competition. It is worth noting that the interviewees had mixed perceptions about this matter. In the following sub-sections their views are highlighted.

549 Interview with joint venture manufacturing firms in Muscat, General Manager (Operations) in Reem Batteries & Power Appliances Co. SAOC.
550 Interview with joint venture Law firm in Muscat, Resident Managing Partner, Trowers & Hamlins
551 Interview with an official, Seniore Economist in the Central Bank of Oman.
6.2.1 Labour mobility

Interviewees were asked their views about labour mobility (employment turnover) between both parties. Specifically the question was, are there any movements of workers from MNC enterprises to domestically owned enterprises? And what impact do MNCs have on the domestic enterprises in this respect?

Productivity spillovers through labour mobility arise when trained local employees move to local firms or start their own business. It has been found that both positive and negative effects have been expressed in relation to labour mobility. For example, the findings from interviews confirm that this mechanism has a positive response in terms of the practicality of this mechanism for productivity spillovers. However, interestingly its impact in Oman was found to be limited because of the unique structure of the labour market. Oman is an oil economy characterized by the dominant role of the public sector, which reflects a high degree of preference from the national human resource for public sector jobs and resistance towards private sector employment. This fact was among the main causes of slow performance of the private sector in general and productivity spillovers in particular. In addition, from interviews it was found that the spillover is more likely to happen when the absorptive capacity of the local firm is high. This was clearly expressed in the following quotations:

‘People are the important aspect of any enterprise. And therefore when the multinationals come here there are lots of opportunities for interaction, not only interaction locally here but training and people going overseas into the multinationals head offices to gain a lot of knowledge and experience, but this is not happening here’. (IF5)

The interviewee added that:

‘Knowledge and experience, nobody can take away from anybody. So once you have been trained, once you have the knowledge, once you have the experience, you can definitely put it to use in the future’. (IF5)

The same point was stressed by other foreign investors stating:

552 Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC
‘Foreign companies definitely provide training to people in domestic companies in the same industry, because it is in their interest ultimately to see that the local enterprise is able to succeed where they have invested, so they are definitely looking at training, upgrading the service levels and skills of people. This ultimately then benefits the enterprise anyway’. (IF38)\(^{553}\)

‘Through the training like any foreign investor when he comes off the course he will employ some Omani staff and do training for them in order to bring them to up to the level at which he wants to operate.(IF36)\(^{554}\)

‘In general Omanis prefer to move from the local companies to the multinational companies. Why there are different reasons. One of the reason is because of the name, the brand’. (IF12)\(^{555}\)

‘Yes, we do a lot of training for our staff because we believe that training as it is in general in any industry, one of the critical success factor for any organization, it’s the staff’. (IF38)\(^{556}\)

‘Most of the foreign companies especially companies who came from Europe or America they believe in that because this is the only way to increase your productivity and satisfy the customer through your staff. So training and development is crucial’ (IF12)

A similar views was emphasized by an official interviewee, who stated:

‘Many FDI institutions recruit Omani young people. For example the statistical data in 2011 show that 35.8% of workers were Omani (Out of 225 thousand workers)’ (IO3)\(^{557}\)

On the other hand, he argued that domestic firms can also be attractive to employees, for various reasons

‘Sometimes workers find the domestic companies have more incentives than MNCs so they move to work for them. Other workers are looking for stability, so they think that they can find that with domestic companies. And some of them are interested in the location of work (very closed to their hometown)’ (IO3)

Based on these findings, it appears that the majority of interviewees strongly believed that productivity can be accelerated if national human resources engage in the process. Basically, this finding is in line with the Chatham House report assessing the Omani labour market.\(^{558}\)

\(^{553}\) Interview with foreign manufacturing firms in Muscat, CEO, Oman Food Investment Holding Co. SAOC

\(^{554}\) Interview with foreign manufacturing firms in Muscat, Managing Director in Safety industry.

\(^{555}\) Interview with foreign tourism firms in Duqm, General Manager in Crowne Plaza Duqm

\(^{556}\) Interview with foreign manufacturing firms in Muscat, CEO, Oman Food Investment Holding Co. SAOC

\(^{557}\) Interview with an official, Director General, Oman Chamber of Commerce & Industry.

\(^{558}\) Chatham House (2014), the Royal Institute of International Affairs, Elusive Employment: Development Planning and Labour Market Trends in Oman.
6.2.2 Demonstration effect

Turning now to the demonstration effect, the second channel of productivity spillovers highlighted during the interviews, in general, all the interviewees acknowledged the importance of this channel as a mode for productivity spillovers. However, according to some interviewees, the effectiveness of this channel depends on the capability of domestic industry itself, as a minimum level of knowledge is required. Also, it requires some degree of similarity between the goods produced. If these conditions are not met, local firms will most likely fail to adopt the new knowledge brought in by MNCs. This statement was clearly confirmed by a foreign investor, as shown below:

‘.... spillovers depend on the ability of domestic companies to learn, stronger and bigger the more they can learn; in Oman local companies need to improve their own absorptive capacity’ (IF37)\textsuperscript{559}

A specific example of an area where such learning was needed was brought up by a local investor, as mentioned below:

‘Local people need to learn how to exhibit from foreign companies who have experience because our business is to sell more and to sell more means to exhibit more in exhibitions and to exhibit we have to teach the team how to exhibit, what to do in exhibitions, how to attract people, how to sell and at the same time how to motivate them. So to motivate them is to send them out to learn more’. (ID11)\textsuperscript{560}

In general, the interviews show that there has been slow progress in terms of productivity spillovers through demonstration effect in the manufacturing sector in Oman. It occurs at a company level but has not been institutionalized to a bigger scale, which would allow it to be adopted by domestic companies.

6.2.3 Business linkages

With regard to the third mechanism, business linkages, the interviews show a good level of business linkages, particularly backward linkages with suppliers as MNCs prefer to focus on their core business and transfer other non-core business to domestic firms. There has a positive influence on the

\textsuperscript{559} Interview with foreign Oil and gas firms in Muscat, Supply Chain Manager, Occidental Of Oman, Inc.

\textsuperscript{560} Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
supplier productivity and increases demand for their products. Nevertheless, according to some foreign investors, the absorptive capacity of domestic firms is an important element in any kind of business linkages. The domestic companies need to have some minimum capability in order to be able to take on board new practices and introduce any changes suggested by MNCs. This point was stressed by some foreign interviewees:

‘The linkages are strong and I think through the global network of a multinationals they can take a lot of very good practices being developed in Oman. We really think the linkage between domestic enterprises and ourselves is complementary’. (JV19)  

‘If you look at the service industry there are many multinational companies who have set up there, they have brought a lot of marketing expertise, lot of technology, a lot of business systems etc., which have helped the local enterprise to emulate and they can follow the same practices and learn from them and therefore help them to improve’. (IF5)  

‘As a foreign company, we choose to focus on our core business activities and subcontract other activities to local firms’ (IF12)

This issue was strongly supported by official interviewees, by stating:

‘Yes, there are business linkages. Sometimes the domestic enterprises operate their business with small capital and limited resources. But when they cooperate with MNCs that will open the door to improve their business in many aspects (technology, management, market, etc.)’ (IO3)  

‘it’s good, we have business linkages but need to develop more, and cover a big number of enterprises, not only focusing on some sectors, big scale that can cover more small and medium enterprises’. (IO7)  

‘A lot of local companies are engaged with these multinational companies to offer services particularly in operations and maintenance’ (IO42)

The same point was stressed by local investors stating:

‘Yes, the history and accumulated experience of MNCs brings with it a lot of experience and know-how and best practices. This exposure by local firms and the linkage sought will improve the way local business do their work. A clear example will

561 Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
562 Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC.
563 Interview with foreign tourism firms in Duqm, General Manager in Crowne Plaza Duqm.
564 Interview with an official, Director General, Oman Chamber of Commerce & Industry.
565 Interview with an official, Director General, Investment Promotion, in Public Authority for investment Promotion & Export Development.
566 Interview with an official, CEO Freezone Sohar (SFZ).
be a small local firm that may work with a large one will need to apply system, HSE and safety to be able to do business. (ID38)\textsuperscript{567}

‘For a multinational to be successful in Oman (it) has to embrace the local content’. (ID19)\textsuperscript{568}

Opposite arguments were raised by both foreign and local investors, who criticized each other. For example, some local investors argued that MNCs are not willing to provide any support to them and only seek to maximize profit, damaging local companies. One interviewee acknowledged that, by stating:

‘There are few linkages at a big company level and within a small scope, particularly in some oil companies’ (ID11)\textsuperscript{569}

In contrast, some foreign investors said that local companies lack the minimum skill required to learn.

‘The domestic firms appear not to have a sufficient capacity in terms of knowledge, skills, experience and attitudes and behaviors’ (IF36)\textsuperscript{570}

6.2.4 Competition

As far as the fourth mechanism (competition) is concerned, there were mixed opinions toward whether MNCs compete with domestic industry. Some interviewees, particularly from local investors, argued that MNCs clearly compete with them, as shown in the following statements:

‘Yes, MNCs do compete with domestic firms especially in areas of construction, logistics, retail and IT’. (ID38)\textsuperscript{571}

‘Obviously there is a lot of competition sometimes people feel that these MNCs are coming to eat up our share’. (JV18)\textsuperscript{572}

In contrast, other interviewees expressed the view that MNCs play a complementary role, having different market targets, mainly for export, and that

\textsuperscript{567} Interview with domestic manufacturing firms in Muscat, CEO, Oman Food Investment Holding Co. SAOC.
\textsuperscript{568} Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
\textsuperscript{569} Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
\textsuperscript{570} Interview with foreign manufacturing firms in Muscat, Managing Director in Safety industry.
\textsuperscript{571} Interview with domestic manufacturing firms in Muscat, CEO, Oman Food Investment Holding Co. SAOC.
\textsuperscript{572} Interview with joint venture Law firms in Muscat, Resident Managing Partner, Trowers & Hamlins.
they are useful for the local economy and they interact with local suppliers in beneficial ways. This opinion was stressed by other interviewees by stating:

‘MNCs are rather in partnership with domestic enterprises with little room for competition’ (IO43)\(^{573}\)

‘We don’t compete with domestic organizations. We are here to promote and develop and continue to increase capability’. (IF36)\(^{574}\)

‘No I don’t think that MNCs are competing with domestic companies at the moment because there is a huge demand in Oman’. (IF12)\(^{575}\)

‘No, I don’t think so. I don’t think so. Because these multinational companies they have, you know, a very very specific goal, you know in terms of their investment. They come to Oman with a specific project, with specific dimensions of that project and that's what they are engaged in’. (IO42)\(^{576}\)

‘I don’t think so, because Oman has a small market around 3 million and MNCs think about export because of their capacity and they can reach the international market’. (IO7)\(^{577}\)

There is a third view, expressed by other interviewees, that competition is a healthy practice in any market and the globalization trend forces the movement of MNCs. Therefore, local industries must take necessary step to upgrade to enable themselves to compete locally and internationally. Two investors acknowledged that by stating:

‘Of course they compete but in such a way that it improves the quality, it depends in the product, the prices’ (ID11)\(^{578}\)

‘Obviously you have to compete to be successful’. (IJV13)\(^{579}\)

Overall, it appears that the competition mechanism is seen as creating a good business environment.

\(^{573}\) Interview with an official, Senior Economist in the Central Bank of Oman.

\(^{574}\) Interview with foreign manufacturing firms in Muscat, Managing Director in Safety industry.

\(^{575}\) Interview with foreign tourism firms in Duqm, General Manager in Crowne Plaza Duqm.

\(^{576}\) Interview with an official, CEO Freezone Sohar (SFZ).

\(^{577}\) Interview with an official, Director General, Investment Promotion Public Authority for investment Promotion & Export Development.

\(^{578}\) Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.

\(^{579}\) Interview with joint venture manufacturing firms in Muscat General Manager (Operations), Reem Batteries & Power Appliances Co. SAOC.
6.3 Key factors for productivity spillovers enhancement

The study found that all interviewees acknowledged that, in order to encourage productivity spillovers, government must play a strong role, with a high degree of coordination between different government institutions on the one hand and coordination with the local business and MNCs on the other. The partnership between these stakeholders must aim to deal with all difficulties preventing smooth productivity spillover. For example, different ministries see different ways to achieve their aims; PAIPED would like to remove the minimum capital requirement for foreign investors and allow full foreign ownership, while the Ministry of Commerce and Industry believes that a minimum capital requirement is needed as a sort of screening mechanism and the partnership between foreign and local investor will ensure greater degree of productivity spillovers.

In the interviews, respondents were asked: ‘How would you rate your level of satisfaction with quality of the key determinants of spillover from MNCs that may influence linkage formation?, with particular reference to absorptive capacity which includes, human capital, R&D, intellectual property rights and institutional framework’?

6.3.1 Human Capital

Although some interviewees were generally positive about the extent to which Omani human resources had the ability to learn and adopt new features from MNCs, most had mixed or negative feelings because Omanis are more motivated to work in the public sector and see the private sector as a transit to the former, as shown in the following statements:

‘Human resources (are) the key element to any enterprise. It is not the building, it is not the furniture, it is the human resources people who run and make the business and therefore proper training, proper based training, I would say, which is available or required by the industry’. (IF5)\(^{580}\)

‘Not satisfied’ (IO43)\(^{581}\)

\(^{580}\) Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC.

\(^{581}\) Interview with an official, Senior Economist in the Central Bank of Oman.
‘Omanis prefer to wait for public jobs instead of working in private sector’ (IO30)582

‘I think you can never stop investing in human capital’. (ID19)583

‘There is still a lot to be done about small and medium enterprise in Oman. You know, it's still very dominated by expatriates’ (IO42)584

‘We need to educate our people that human resource is the power of manufacture’ (ID11)585

‘We need more engagement between the foreign direct investments and the private sector, to educate, to train and to qualify the local labour force’. (IO42)

This clearly illustrates that there were low levels of satisfaction with Omani human resources. This finding was confirmed by several Omani publications including the recent report publish by the Omani Ministry of Labour.

6.3.2 Research and Development capacity

Although, in overall terms, R&D is progressing in Oman, particularly in the public sector, the private sector has a limited capacity. This is due to the fact that the private sector is scattered in small units and does not have the resources and ability to do R&D. This was stressed by some interviewees stating:

‘No that's the area that we have been lacking as a country, innovation and what you call technologies, an area that where we are behind’. (IJV18)586

Other interviewees expressed their feelings on this matter:

‘Not satisfied’ (IO43)587

‘Nothing, it’s a big zero, sorry to say that’ (IO23)588

‘It is limited; more needs to be done’ (IF5)589

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582 Interview with an official, Director General of Rusayl Industrial Estate, Public Establishment For Industrial Estates.
583 Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
584 Interview with an official, CEO Freezone Sohar (SFZ).
585 Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
586 Interview with joint venture Law firms in Muscat, Resident Managing Partner, Trowers & Hamlins.
587 Interview with an official, Senior Economist in the Central Bank of Oman.
588 Interview with an official, Director of Media & Communication, Public Establishment for Industrial Estates.
589 Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC.
‘No we don’t have much of R& D’ (ID11)

‘R&D is something which we still have not really focused on widely in the country. There are some research and development centres but I think more and more that will be very important for the future’ (IO43)

‘Local companies I don’t think have got too much of facility because R & D requires both time and capital. So R & D is normally administered by big companies’. (IJV13)

‘We are very behind in R&D. There is no law at the moment that forces local companies or any companies to spend money on R & D.’. (IJV18)

6.3.3 Intellectual property rights

In terms of property right in the context of productivity spillover, Intellectual property laws, by royal degree no.37/2000, promulgating the law of trademarks, indications and secrets and protection from unfair completion, this study found that Oman has an IP law although this law is not implemented. This was expressed in the following quotations:

‘Not satisfied’ (IO43)

‘It is quite good’ (IJV13)

‘IP as a law it’s there but as practice it needs more enforcement’ (IJV18)

6.3.4 Institutional framework

There were unexpected negative findings concerning the institutional framework, because Oman has a large public sector, which is the preferred place of employment for nationals due to many advantages they receive, so it is expected to perform very efficiently in a coordinated manner. However the majority of interviewees had the opposite opinion as indicated below:

‘Not satisfied’ (IO43)

‘We have different government bodies, but we don’t have a tool for linkages. There is Ministry of Foreign Affairs, OCIPD, Ministry of Commercial Industrial, Oman Chamber

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590 Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
591 Interview with joint venture manufacturing firms in Muscat, General Manager (Operations), Reem Batteries & Power Appliances Co. SAOC.
592 Interview with joint venture Law firms in Muscat, Resident Managing Partner Trowers & Hamlins.
593 Interview with an official, Senior Economist in the Central Bank of Oman.
of Commerce, Public Establishment of Industrial State. But none of them focus on building relations between foreign companies and local companies’. (IO21)

‘We need to have a strategy and requirements that are enforceable and measurable and done by trained and qualified technocrats’. (IO30)

‘No one works under a very clear prescribed mandate’ (ID19)

‘We have different organizations. They compete with each other and that's not healthy and not going to help the local economy, if we had an organization that actively participates, you know in that joint venture, shares responsibility, shares liability, shares financial risk then it becomes more and more successful’

‘Having an official body that acts as a catalyst for FDI and the private sector will help to strengthen the relations and facilitate a lot of cooperation between them’. (JV13)

‘The management who we have in the team in the free zone are not well organized and not well professional’ (ID15)

Based on the evidence above, interviewees found that preconditional factors for productivity spillovers are a matter of concern and this may explain the limited size of productivity spillovers. This calls for an urgent move by the authority to put in place proper policies that can improve the key factors for spillovers to occur, otherwise no matter how much inward FDI is brought in, the benefits to local enterprise will remain limited.

6.4 The Role of Government

Interviewees were asked their views about the effectiveness of policy instruments and platforms. Specifically the question was, ‘How would you assess the effectiveness of policy instruments and platforms in Oman in achieving the spillover objectives?’. This statement was from an experienced foreign investor commenting on the role of government:

‘When we speak about spillover we need to speak about the role of government, as spillovers do not occur without proper policies and enforcement mechanisms’ (IF10).

594 Interview with an official, Director General of Research & E-Services, Public Authority for Investment Promotion & Export Development.
595 Interview with an official, Director General of Rusayl Industrial Estate, Public Establishment for Industrial Estates.
596 Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
597 Interview with joint venture manufacturing firms in Muscat, General Manager (Operations), Reem Batteries & Power Appliances Co. SAOC.
598 Interview with foreign manufacturing firms in Sohar, Head, Oman Pharmaceutical Products Co. L.L.C.
The majority of interviewees felt that policies and platforms were insufficient and inefficient. Consequently, the researcher found that a lot of interviewees were not aware of any institution that focused on ensuring that policies were designed and implemented in a manner that would boost productivity spillovers. A foreign interviewee expressed his view on this matter in the following way:

‘I don’t recall any public institutions in place in Oman that ensure and encourage spillovers. Off course it would be very useful’. (ID11)\(^{600}\)

Other interviewees similarly provide shortcomings in this area.

‘we need to promote a policy that promotes skills and capacity building, build required infrastructure to promote and harness local entrepreneurial skills, devise business laws that are geared towards promoting linkages with results clearly pointing to a win-win situation for both the investors and the domestic economy’. (IO43)\(^{601}\)

‘Policies still require further refinement’ (IO42)\(^{602}\)

‘Certain parameters or certain governance is required, especially in the areas of spillovers of skills between foreign and local players’ (IF5)\(^{603}\)

In terms of ownership structure, although many interviewees did not answer this question, some of them supported the view that joint ventures were a more useful mode to achieve productivity spillovers, as expressed in the following extracts:

‘The joint venture is better because if you leave it 100 % for the foreign than what is the use of the local companies and transfer of technology, transfer of many things’. (ID11)\(^{604}\)

‘It depends on that JV and that partnership. If it’s a sleeping partner it doesn’t create much value’ (IO42)\(^{605}\)

‘if we did not have been a joint venture we never would have been able to develop the product that we have done’ (IF19)\(^{606}\)

\(^{599}\) Interview with foreign manufacturing firms in Muscat, General Manager in Muna Noor Manufacturing & Trading LLC.

\(^{600}\) Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.

\(^{601}\) Interview with an official, Senior Economist in the Central Bank of Oman.

\(^{602}\) Interview with an official, CEO Freezone Sohar (SFZ).

\(^{603}\) Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC.

\(^{604}\) Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.

\(^{605}\) Interview with an official, CEO Freezone Sohar (SFZ).

\(^{606}\) Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
‘By having a joint venture, locally we would not been able to deliver the success that we have delivered if we hadn’t entered into the joint venture arrangement with our partner.’ (IJV36)

Overall, the majority of interviewees welcomed the idea of a special institutional body that would be responsible for dealing with all issues relating to productivity spillovers, and work as a moderator among all stakeholders to ensure that MNCs and domestic enterprises work in a more mutually beneficial way.

Turning now to the question whether there are any specific factors that are likely to bring about a greater degree of linkage, interviewees highlighted some areas that can help Oman manufacturing firms to enhance productivity spillovers. One interviewee emphasized this point by stating:

‘The local economy needs more efforts to enhance. For example improving human resource, proving more incentives, open more sectors to invest’ (IO3)

6.4.1 Detailed Business linkages programme

With regard to whether preparation of the detailed linkages programme would have a significant positive impact in attracting and monitoring FDI, the majority of interviewees agreed strongly, as shown in the following statements:

‘Strongly agree and should be part of the overall strategy’. (IO43)

‘Once they have a plan, a clear plan and set the target suitably, I think that will help the, or enhance the spillover tapping’. (IF5)

‘Yes of course, preparation of a detailed linkages programme along with an Investment Map would have a significant positive impact in attracting and monitoring FDI, I think it’s very very useful and I think this is what is missing in Oman. That everybody is going his own way, let’s say even the FDI, when they come here they just come without sitting together, without sitting at one table with all the three sectors, all the three you know. The government sector should sit with FDI and the local companies which will have a joint venture or something’. (ID11)

607 Interview with foreign oil and gas firms, Supply Chain Manager, Occidental Of Oman, Inc.
608 Interview with an official, Director General, Oman Chamber of Commerce & Industry.
609 Interview with an official, Senior Economist in the Central Bank of Oman.
610 Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC.
611 Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
‘Yes, because a detailed linkages programme along with an Investment Map will ensure whatever is in the interest of the country’. (JV13)<sup>612</sup>

6.4.2 In country value

In Country Value (ICV) or In Country Requirements (ICR) is defined as the total spend retained in country that benefits business development, contributes to human capability development and stimulates productivity in Oman’s economy. This concept was addressed by H.M the Sultan in the annual session of the 5th term of the Council of Oman for 2012, HM: “…We have instructed our government to focus, in its future plans, on social development, particularly its aspects related to the daily lives of citizens. This should be achieved by the creation of renewable employment opportunities and training programmes for citizens and promoting production capacity, as well as scientific, cultural and intellectual development. We will closely follow the steps taken in this field”. In Oman the ICV Strategy has two key objectives first, Omanisation of skilled contractor personnel and second, increasing in country spending on goods and services. However, there are key challenges to ICV, including mindset change both internally and externally on ICV as a good business, additional supply chain costs (investment), ensuring a transparent and objective bid evaluation environment, alignment with other operators and government stakeholders on ICV delivery enablers. One interviewee emphasized this point by stating:

‘The in country value agenda, I think it is really going to encourage multinationals to rethink their approach to doing business in Oman, rather than relying on imports. I think we are going to see a big drive towards developing products locally but it needs the support and the weight of the government behind them to ensure that these strategies are implemented’. (JV19)<sup>613</sup>

6.4.3 Investment Map

Some interviewees emphasized on Investment Map as a precondition factors for productivity spillovers to occur. This map helps in monitoring FDI in reaching a win-win situation for both FDI investors and the host economy. This opinion was stressed by a number of interviewees, who commented as follows: by stating:

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<sup>612</sup> Interview with joint venture manufacturing firms in Muscat, General Manager (Operations), Reem Batteries & Power Appliances Co. SAOC

<sup>613</sup> Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel
‘A lot of investors like Oman, they would like to invest here but they don’t have a business profile, they don’t know in what kind of area we want a guideline or a project, we want to start it and also we don’t have it’. (IO23)

‘If certain targets are made, if certain areas of target areas and segments, maybe the small scale industry where, you know, FDI can be attracted, that could be a positive move by government’ (IF5)

‘Business maps are not much available, we need to really focus on this. I think this is very important because the FDI which comes to the country for the first time and tries to investigate takes a lot of time to see the opportunity’. (ID11)

‘Providing business maps is great because when Oman is go overseas to do marketing they will say look we need the following one, two, three, four, we need a chemical factory, we need a pharmaceutical factory, it will be in that region, and you need to give a reason why you put it in that region’. (IF12)

‘The Omani government need to be more practical, the real business is happened when you make a call and say Mr. X you are producing this, I want this to be produced, what can I do to help you to come and you know so we need to know that’. (IJV18)

A Similar views was emphasized by an official interviewee, who stated:

‘Oman needs an investment promotion strategy which identifies what are sectors that Oman has come with business and based on that, where are target countries to import an FDI, and which sector to start with’. (IO7)

The interviewee added that:

‘Strongly yes, foreign investors or FDI can benefit from preparing an investment map. When you say investment map, you say a lot of things: legal, operational, promotional, all these things come under investment map’. (IO7)

6.4.4 Institutional arrangement:

The results show that the majority of interviewees acknowledged that there is no such institution available in Oman, although the government has an essential role to play in achieving productivity spillover objectives and shaping MNCs’ activities through strengthening the absorptive capacity of the private

614 Interview with an official, Director of Media & Communication, Public Establishment for Industrial Estates.
615 Interview with foreign manufacturing firms in Sohar, Senior Vice President in Shadeed Iron & Steel LLC.
616 Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
617 Interview with foreign tourism firms in Duqm, General Manager in Crowne Plaza Duqm.
618 Interview with joint venture Law firms in Muscat, Resident Managing Partner Trowers & Hamlins.
619 Interview with an official, Director General, Investment Promotion, Public Authority for investment Promotion & Export Development.
sector and applying needed policies to influence the operations of MNCs. At the same time, it was thought the government should provide stable macroeconomic policies and an investment friendly environment, and build a reliable legal framework and other commercial institutions:

‘There are scattered effort was done by different organization or department but there is no such one unique for evaluating and dealing with this spillover between MNC’. (IO7)

In terms of institutional arrangements in the context of productivity spillover, this study found that currently there are different institutions dealing with this matter in conflicting ways. For example, the Ministry of Labour is interested in Omanization policies, while both local and foreign investors viewed this as preventing their business from performing efficiently because Omanis are waiting for a better opportunity in the public sector, which will come sooner or later, and are not motivated to make the needed efforts to learn the skills necessary to do the job. The respondents emphasized the importance of having a public institution in place that can ensure and encourage spillovers between MNCs and domestic enterprises, as spillovers do not occur naturally.

‘One of the problematic areas, one of the gaps here in Oman is that the government sector are not communicating together’. (IO22) 620

‘There should be institutions that regulate attract and set unified regulations and rules for investment in country’ (IO3) 621

‘I think formation of a body to act as catalyst for foreign direct investment and the private sector will assist quite a lot because it is, good confidence level will be there in the private sector also that they having somebody in between, so no adverse or no actions of theirs will go to their disadvantage. Because security will be better’. (ID35) 622

Based on the findings above, a few issues emerged that needs to be considered, as productivity spillovers do not happen naturally. Government policies needs to be reviewed and a move made toward more enabling policies such as have been applied in other countries with a similar economic structure.

620 Interview with an official, Director of Operations, Public Establishment For Industrial Estates.
621 Interview with an official, Director General, Oman Chamber of Commerce & Industry.
622 Interview with domestic manufacturing firms in Muscat, Managing Director, Windows 2000 (uPVC windows and doors).
Overall, it appears from the interviews that there is a need for a new agenda of policies toward FDI that will maximize the benefits that can enhance the economic development process. These are related to employment, investments, diversification and exports, in addition to the benefits related to enhancing the productivity of the local firms, which is the focus of this study.

‘Government at this stage they need to emphasize more on two things: one education, which means creating the colleges and institutes. And number two is to emphasize the local population who are employed at the moment to do training courses and development, to improve their capability’. (IF12)

‘Oman must provide skilled labour to succeed, For example in Dubai you will find more skilled labour than in Oman; it’s a crucial thing’. (IF12)

‘Oman has to focus on developing the middle level human resources because they are able to learn and help’. (IJV13)

6.5 Benchmarks and Best Practices in Achievement of Productivity Spillover

During some of the interviews, a number of benchmarks and best practices derived from the experiences of other countries were highlighted. According to some interviewees, Oman can draw lessons from the success of countries in South Asia (e.g. Singapore and Malaysia) and Latin America (e.g. Mexico), particularly on how to attract and monitor the impact of FDI to meet national objectives. Singapore is an interesting example for Oman because the public sector in Singapore, like Oman, plays a dominant role in economic activities and this sector was crucial to Singapore’s success in attracting and managing the MNCs to benefit domestic business.

In addition, interviewees commented that many countries have designed and implemented good solutions to facilitate spillovers. These include smart laws and procedures and programmes that have demonstrated their efficiency in one country and may be useful to other countries confronting the same problems. Sharing solutions could considerably accelerate the pace and reduce

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623 Interview with foreign tourism firms in Duqm, General Manager in Crowne Plaza Duqm.
624 Interview with joint venture manufacturing firms in Muscat, General Manager (Operations), Reem Batteries & Power Appliances Co. SAOC.
the cost of government investment in spillovers. The findings in this area were supported it by some of interviewees’ statements as following:

‘Examples include South Korea, Malaysia, Singapore and Chile’. (IO43) 625

‘Different countries have different levels of development and maturity’ (JV19) 626

‘China, as a big factory for the world, does a lot of things to transfer technology and skills from multinational to local companies’ (IO23)

‘Saudi Arabia has succeeded because they bring big brands and those brands invest in Saudi Arabia and manufacture in Saudi Arabia and become very well known. For examples companies like Aerial, and Signal two those consumer products have become very well-known international products and now they are made in Saudi Arabia’. (IO23) 627

‘In Asia itself, Vietnam is one area where if you see in the last ten years there has been a substantial multinational FDI flow from the Japanese, from the Chinese, from other major players in Asia, who have set up their operations in Vietnam, so therefore there is a lot of things one can experience or one can learn’ (IF5) 628

‘The Singaporean and Malaysian experiences are the best practices in FDI in the world’. (IO3) 629

‘Singapore, Korea, Ireland, Turkey and Malaysia’ (ID38) 630

‘I think if we want to learn about FDI, the best countries are Germany and the USA’ (ID11) 631

6.6 SWOT analysis

This part of the analysis provides a SWOT (Strengths, Weaknesses, Opportunities and Threats) in relation to attracting FDI and formulating business linkages with domestic enterprises. SWOT analysis is a straightforward model that provides direction and serves as a basis for the development of spillover implementing plans. It accomplishes this by assessing strengths (what an organization can do), weaknesses (what an organisation cannot do), opportunities (potential favourable conditions for an organisation) and

625 Interview with an official, Senior Economist in the Central Bank of Oman.
626 Interview with joint venture manufacturing firms in Sohar, Managing Director in Bahwan Exel.
627 Interview with an official, Director of Media & Communication, Public Establishment for Industrial Estates.
628 Interview with an official, Director of Media & Communication, Public Establishment for Industrial Estates.
629 Interview with an official, Director General, Oman Chamber of Commerce & Industry.
630 Interview with domestic manufacturing firms in Muscat, CEO, Oman Food Investment Holding Co. SAOC.
631 Interview with domestic manufacturing firms in Muscat, Director Poly Products L.L.C.
This analysis provides a useful framework for productivity spillovers enhancement within the context of Oman. It is a summary of the current situation of the Omani business environment in relation to attracting FDI and formulating business linkages with domestic enterprises. The strengths and weaknesses are identified, along with the opportunities and threats in the environment. The SWOT analysis allows the current state and future potential to be evaluated. This analysis can also be used to build strategies for the future by considering how weaknesses can be turned into strengths, and how threats can be turned into opportunities.

Several areas and categories identified in SWOT analysis are:

**Strengths**
- Infrastructure: roads, ports, utilities, connectivity and transport system (repeated by 31 participants)
- Labour Market: young population, availability of local workforce, access to cheap, educated, labour from Asian countries (repeated by 24 participants)
- People: friendly, educated, willing to work, very nice, truthful (repeated by 20 participants)
- Macro stability: low inflation rate, fixed exchange rate with no foreign exchange control (repeated by 20 participants)
- Location: neighbouring countries (repeated by 19 participants)
- Trade: liberal regime, WTO membership, positive bilateral and multilateral relations, fast import processing, export friendly, easy access to new markets (repeated by 18 participants)
- Tax: no personal income tax, no consumption or production or value add tax, low tax base for business, exemption 5+5, tax incentive (repeated by 18 participants)
- Resources: vast petroleum, energy, rich minerals and raw materials, unexploited natural beauty, industrial state, deep sea (repeated by 12 participants)
- Government institution: good credit rating of government institution, stable government, good government support (repeated by 11 participants)
- Market size: growing, huge potential, huge local demand (repeated by 11 participants)
- Political stability (repeated by 11 participants)
- Access to finance: Oman Development Bank, AIRUFD, strong commercial banks (repeated by 9 participants)
- Ownership structure: foreign investors

**Weaknesses**
- Government: slow decision making, efforts scattered and not linked, too many initiatives with less focus on execution, bureaucracy, intra institution interaction not strong enough, regulations are not fully understood by institution, lack of coordination, policy structure has no horizontal linkage - private to private and government to government, every institution works on its own (repeated by 35 participants)
- Labour Market: lack of adequate national workforce, difficulties in obtaining labour clearance, Omanization policy, high labour cost, irresponsible work ethic from locals, over reliance on foreign labour, locals need better training (repeated by 28 participants)
- Market: limited, business monopoly, not vast (repeated by 18 participants)
- Non availability of raw materials (repeated by 12 participants)
- Lack of research and development, studies, and consultants (repeated by 11 participants)
- Overdependence on oil (repeated by 11 participants)
- Overdependence on imports (repeated by 10 participants)
- Very high interest rate and security demand for credit by financial institutions (repeated by 10 participants)
- Weak transportation system (repeated by 8 participants)
- Telecom and broadband need to be improved (repeated by 5 participants)
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<tr>
<th>Opportunities</th>
<th>Threats</th>
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<tr>
<td>• Location (repeated by 23 participants)</td>
<td>• Unhealthy competition from regional and international players (repeated by 23 participants)</td>
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<td>• High rate in investment allows capital to be recouped in a short time (repeated by 15 participants)</td>
<td>• Heavy reliance on energy revenue for major part of government finance with limited gas and oil resources (repeated by 15 participants)</td>
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<td>• Trade: base to export to GCC and big market in India, Iran and Pakistan (repeated by 15 participants)</td>
<td>• Labour market: compliance rules with respect to Omanization, poor work skill among nationals, immigration visa policy (repeated by 14 participants)</td>
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<td>• Untapped resources (repeated by 14 participants)</td>
<td>• Uncertainties of political environment of the region (repeated by 12 participants)</td>
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<td>• Free zone in Duqm (repeated by 11 participants)</td>
<td>• Government: changing the laws very quickly, policies, long term political stability (repeated by 10 participants)</td>
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<td>• Great opportunities in tourism, fisheries and mining (repeated by 11 participants)</td>
<td>• Lack of clear plan for development (repeated by 9 participants)</td>
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<td>• Committed government spending for improving infrastructures (repeated by 10 participants)</td>
<td>• Not enough clarity on the rules and regulation and laws (repeated by 8 participants)</td>
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<tr>
<td>• Huge potential in Services sector (repeated by 9 participants)</td>
<td>• Replacement of oil with other energy resources (repeated by 4 participants)</td>
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<td>• People: young, willing to work (repeated by 9 participants)</td>
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<td>• As an oil based economy, open opportunity in petrochemical and oil based industry (repeated by 9 participants)</td>
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<td>• Huge growth potential in power and water sector (repeated by 8 participants)</td>
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<tr>
<td>• Market: booming, open, growing with high demand (repeated by 8 participants)</td>
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<tr>
<td>• Encouraging government policies (repeated by 6 participants)</td>
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<td>• Small scale industry (manufacturing) (repeated by 6 participants)</td>
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<td>• Development of railway network (repeated by 5 participants)</td>
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6.7 Chapter Summary

Overall, the chapter supports the earlier findings from the quantitative survey data that although Oman succeeds in attracting FDI, the spillover effects have been limited and there is a need for a new policy agenda toward enhancement of spillover effects. For the first objective, the findings from the interviews demonstrate that Oman has a massive potential and would greatly benefit from FDI. However, the key issues for Oman to be able to benefit from FDI to have the right absorptive capacity and prepare the ground and preconditional factors as benefit from FDI do not happen automatically. The
productivity spillovers from MNCs to domestic manufacturing firms are dependent on the ability of Omani firms to learn different skills, practices, and features from foreign companies and use these in the local environment. Labour mobility and demonstration effects have not yet played a significant role as mechanisms for spillovers which is attributed to the preference of local human resources to work in the public sector rather than the private sector and limited leaning capacity of domestic firms, which are fragmented into small units.

The second objective was to identify the policies Oman needs to learn from successful international experience to prepare the ground as a precondition for successfully gaining the mentioned benefits. This requires the government to draw up the right policies and undertake the right programmes to create a conducive environment in which businesses can operate efficiently and be more productive. This may include strengthening absorptive capacity, narrowing the technology gap, enhancing forward and backward linkages, developing the institutional framework, and making a trained and qualified local labour force available. To do so, specific policies need to be in place, which may include; domestic content requirement, export performance requirement, ownership structure, investment promotion, local human development requirement and business linkages between MNCs and domestic firms. These were contrasted with policies that minimize the cost associated with FDI, which were highlighted by some interviewees, such as permitting pollution, carrying out operations with inadequate health and safety standards and tolerating the behaviour of abusive subcontractors. Appropriate policies need to be translated into an action plan with proper indicators and a monitoring and evaluation system and the issue of the establishment of an institutional structure for the implementation of the strategy needs to be addressed.632 In terms of benchmark or best practices, the study shows that Oman can draw lessons from the success of countries such as Singapore where the government plays a significant role in attracting FDI and formulating linkages with domestic companies. Other examples include, South Korea, Malaysia, and Mexico.

From the SWOT matrix, it is clear that the weaknesses outnumber the strengths in relation to productivity spillovers enhancement from MNCs to

632 Creation of an enabling business environment and well-functioning and high-quality government institutions
domestic firms. The most important points of strength, which are considered as opportunities, are the strategic geographic location (for market seeking FDI) and other natural resources such as fisheries, tourism sites and the non-oil mineral resources, which have not been used effectively. Also, in the past decade Oman has altered its policies constructively to put the country on a positive track, including liberalising the national economy from the previous domination of the public sector; encouraging local and foreign investment; and establishing a stock market as part of the process of liberalisation in order to facilitate the entrance of multinational companies to help build the Omani economy. In addition Oman has concluded several international and regional agreements, it is a member of a number of multi-lateral agreements, International and regional organizations, has entered into a number of bilateral agreements and has an A+ rating from some recognized rating agencies. The points of weakness, which are considered a threat to FDI, include limited engagement of equipped national workforce with domestic firms, the lack of a clear cut industrial strategy; poor utilization of infrastructure; the failure to establish a one-stop-shop for assisting investment; and the multiplicity of laws and regulations.
Chapter 7
Discussion and Analysis

This chapter brings together the findings from previous chapters and relates them to previous studies and the theoretical body of knowledge, taking into consideration the political and economic environment in Oman. This chapter focuses on discussion of the research findings in relation to the business environment and the overall economic impact of FDI in Oman: productivity spillovers. Also, it focuses on preconditional factors for productivity spillovers, and the effectiveness of policy instruments to achieve high productivity levels in domestic manufacturing firms.

The central research question of this project is to understand the role of FDI in enhancing productivity spillovers in Omani manufacturing firms through different mechanisms. This further includes assessing the effectiveness of policy instruments and platforms to achieve the desired objectives mentioned above. This chapter presents the findings from the various data collected and relates them to the research questions. The findings include the analyses of 42 semi-structured interviews with key stakeholders and a survey which achieved 96 completed questionnaires from local and foreign investors. The discussion will also include findings from secondary data (particularly official economic statistics) presented throughout the earlier chapters. Previous studies have examined the productivity spillovers in manufacturing sector from selected developed economies perspectives, e.g. Caves (1974) on Australia, and Liu et al. (2002), on the UK. There are some studies on productivity spillovers in developing economies; e.g. Kokko (1996) on Mexico, Sjoholm (1999) on Indonesia and on transition economies, such as Sinani & Meyer (2002) in Estonia. However no published results from studies of this kind have been found with regard to the Gulf countries, and hence there has been no investigation of spillover effects in the case of Oman.

As well as studying spillover effects in a previously unstudied region, this study extends existing literature on FDI spillovers in various other dimensions. For example, many existing studies have merely offered a partial description of productivity spillovers effects, by analysing only one of the effects or one
channel of productivity spillovers.\textsuperscript{633} Moreover, many studies have treated the mechanism by which the productivity spillovers are transferred as a black box whereas this study seeks to understand the process by which spillovers occur.\textsuperscript{634} Also, most existing studies take an econometric approach which has some important limitations and of which there is a strong critique.\textsuperscript{635} This study offers a more complete picture of FDI spillovers by distinguishing these spillovers effects according to their channels, mechanism, and precondition factors. Although this study is new in many respects, as outlined above, it naturally benefits from previous studies which have set the stage for this research mainly in the areas of productivity spillovers channels, and the key factors for spillovers enhancement. All this helped to design a distinctive approach for this research. Two areas make this study significant. Firstly, it fills a gap in the global knowledge about the productivity spillovers in oil producing countries characterized by Dutch disease, which have a unique economic structure where the government is dominant in all economic activities. Secondly, FDI has been studied in economies where local human resources are mostly not engaged in domestic firms and which rely mainly on expatriates. Moreover, it is characterised by weak absorptive capacity and ability to learn and adapt new productivity features to local conditions. Therefore, the main research question was: To what extent has FDI been successful in enhancing the productivity of domestic manufacturing firms in Oman?

Rentier state theory has explanatory primacy because it was found suitable for understanding many Omani political and economic factors in context. When oil was discovered, tribal leaders in many of the oil producing countries who made deals with foreign oil companies found themselves in an advantageous economic and political situation. Their alliances were no longer based on the distribution of power, but mainly on the patronage of the ruling families due to the oil revenue they were able to distribute. Oil became more of a political tool rather than an economic one. Thus these states were prone to fall into the

\textsuperscript{634} Go’rg and Strobel (2005), p.695

rentierism due to the shortsighted political use of their natural resources, rather than using these as a means for sustained economic prosperity.

However, after two major economic down-turns due to the drop in the price of oil in the second half of the 20th century, the oil rich countries learned some valuable lessons. While they are not working their way out of the resource curse completely, they are taking new directions so as to not fall into the trap of being exclusively rent-seeking states. Oman has experienced concerning effects during the oil busts such as unemployment and financial instability pushing the monarch to search for new economic mechanisms. Gray's (2011) theory of late rentierism highlights this phenomenon, and is what will be used below to discuss the positive and negative influence of Arab oil producers politically and economically. The theory also helps explain a major point in this research on how the abundance of oil is driving a push to consolidate the elite power structure in many countries, despite acknowledging the need (and opportunity) for forward-looking economic thinking.

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<tr>
<th>Wave</th>
<th>Leading Authors</th>
<th>Key arguments</th>
<th>Explanations</th>
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<tr>
<td>Classical RST</td>
<td>H. Mahdavy (1970)</td>
<td>“those countries that receive on a regular basis substantial amounts of external rent,”</td>
<td>The “socio-political structure” remains so underdeveloped, “imbalance in the input-output matrix.”</td>
<td>High dependences of export and budget on Oil. 85% of jobs created by government.</td>
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<td>H. Beblawi (1990)</td>
<td>“Pure” rentier economy does not exist. The “externality” of rent origin. Only a small portion of the total population is engaged in the generation of rent whereas, “the rest of the society is only engaged in the distribution and utilization of this wealth.” the government is the primary recipient of external rents.</td>
<td>an environment conducive to corruption (no clear conflict of interests between holding public office and running private business at the same time) The government is the largest and ultimate employer;</td>
<td>Oman’s economic cycle is running only in one direction; that is, in the direction of hydrocarbon sales, where the whole country is effected from the plummeting sales of country’s only source of bread and butter. Oman is an absolute monarchy in which all legislative, executive, and judiciary power ultimately rests in the hands of the hereditary sultan.</td>
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<td></td>
<td>G. Luciani (1987)</td>
<td>Allocation versus production states, the role of the economy in determining state behavior.</td>
<td>The bureaucracy is frequently bloated and inefficient. Local laws often make it impossible for foreign companies to operate independently. Citizenship becomes a financial asset.</td>
<td>The government sought to allocate this revenue to the population directly through wages, and allowances (25 percent of total public expenditure) and indirectly through</td>
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### Specialized and Conditional Rentier States (RST)

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<td>Chaudhry (1997), Hertog (2010), Schwarz’s (2008)</td>
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### Late Rentierism Theory

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<td>M. Gray (2011)</td>
<td>The “late rentier” state is responsive but undemocratic. Opening up to globalization, but with some protectionism remaining. State has an active economic and development policy. State is an “energy-driven” vs. “energy-centric” economy. State has an “entrepreneurial state capitalist” structure; state is long-term in its thinking. State maintains an active and innovative foreign policy.</td>
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### Defense and Security Spending

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### Globalization, Economic and Development Imperatives

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### Trade Openness

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Oman is a rental state according to Mahdavy’s criteria because it generates revenue from its natural resources, and these external rents account for a significant portion of the government’s revenue. This externally-derived oil revenue as a percentage of total revenue more than double Luciani’s 40 percent threshold for rentier states, accounting for an average of 85 percent of total revenue during the last decade. The Omani government sought to allocate this revenue to the population directly through wages, and allowances (25 percent of total public expenditure) and indirectly through subsidies (10 percent of total public expenditure). Large-scale public expenditure on the construction of industrial projects (40 percent of private sector employment) heavily favored business family empires that positioned themselves as the sole providers of the necessary goods and services for such projects.\textsuperscript{637}

Despite efforts such as Omanization and an emphasis on decreasing the number of expatriates as a percentage of both the labor force and total population, these industrial projects attracted a large amount of foreign laborers who were preferred by the private sector because of their low-wages and willingness to work longer hours than Omanis. As a result, Oman developed an addiction to foreign labor, and the Omani population, to a degree, allowed this to happen given the strong welfare system of the rentier state in which they could accrue unearned income rather easily without entering the labor market.\textsuperscript{638} This is one version of the breakdown in the work-reward causation in which many Omanis have chosen to benefit from the rentier system rather than fill readily available jobs in the private sector, which have increasingly been filled by expatriates during the last ten years. Because, on average, Omanis

\textsuperscript{637} Ministry of Information (2014), Oman 2013-2014, Oman

\textsuperscript{638} Laura El-Katiri, Bassam Fattouh and Paul Segal( 2011), Anatomy of an oil-based welfare state: Rent distribution in Kuwait, Kuwait Programme on Development, Governance and Globalisation in the Gulf States, LSE’s interdisciplinary Centre, UK
consist of only 10 percent of the labor force in the private sector, it is true that only a small portion of the population is engaged in the generation of rent, whereas the majority is involved in the utilization of it. This labor market distortion in particular has facilitated the onset of rentier mentality in which the Omani population, generally speaking, perceives their prosperity to be directly tied to the state rather than their active involvement in the labor force. More specifically, Omanis see their level of prosperity directly tied to the government’s ability to allocate revenue in a more equitable manner. This is why grievances among the population often focus on the unequal allocation of oil revenue by the Omani government.

Schwarz’s argument that the strength of the state is measured through its ability to effectively operate its administrative functions can be seen to apply in the case of Oman. However, Schwarz solely defines the administrative function as the ability to collect taxes. Yet in rentier states generally, and in the case of Oman specifically, the administrative function should be defined by the state’s ability to allocate revenue. This helps us understand why the Omani government was able to weather the 2011 protests with minimal repression, relative to other Arab Spring cases. By distributing revenue to protesters, the strength of the Omani state was on full display. During the Arab Spring, according to the economist magazine, Arab governments were throwing money at the street. Most Arab regimes were fighting for their lives, in some cases literally.

Schwarz’s work helps us understand how Oman’s state developed differently from the European states, although much of the literature on state development

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643 Marc Lynch (2012), Arab uprisings The Arab Monarchy Debate December 2012, Institute for Middle East Studies at the George Washington University, The Project on Middle East Political Science (POMEPS), POMEPS Briefings 16, George Washington University
is rooted in studies of the latter. To rely on external rents as a primary source of government revenue and to then allocate that revenue throughout the population in ways that inevitably determine “haves” and “have nots” is to construct and operate a state that is very different from those found in Europe or North America, which, as Schwarz mentioned, developed according to a war-making paradigm and drew their legitimacy from the representation function. Instead, legitimacy in rentier states derives from the welfare function, which consists of the interconnectivity between rent collection, allocation, and utilization. As Mahdavy, pointed out, this relationship decreases the sense of urgency for change and incentivizes maintenance of the status quo.

Oman, like many states, falls into the late rentierism theory to varying degrees. In late rentierism, oil producing countries evolve to develop their policies as a result of internal and external forces while still consistent with the basics of the RST, depending mainly on rents. Some of the major forces affecting the change to later-rentierism are: globalization, unemployment, population change, new international imperatives, and business pressure. Along with these factors, they had also learned from previous lessons of their experiences during oil booms in 1970’s and early 1980’s. Those two decades saw revenue wasting and mismanagement. These factors collectively led them to reach an understanding of how regimes begin to become integrated globally and align themselves to becoming a more active and entrepreneurial state. This new system is more conducive to ensuring state longevity by both creating new forms of wealth and avoiding the political risk of neo-liberalization.

During the Arab Spring developments in 2011, the Omani government was open to some internal reform. However, they still maintained characteristics of a rentier state. The reform that took place was a reaction to globalization and to mitigate pressure from a precarious socioeconomic situation where unemployment and inequality are a major concern to extend the regimes’ longevity. The government had to adapt to these changes. Oil revenues alone were not enough to purchase loyalty. As a result, a degree of pluralization in politics occurred in many of these late rentier countries. Most of them

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645 Gray, 2011
646 In Oman government create 50 thousand jobs, change whole cabinet
647 Gray, 2011
introduced reform, although it was frequently limited to modestly expanding power to political institutions and legislatures which did not challenge the status quo.\textsuperscript{648}

According to RST, radical reform might be seen as being constrained by an informal contract that comprises minimal taxation for citizens who also enjoy some oil revenue but in return have a lower participation in decision making. However the legitimacy of the contract must be in question since the people do not have a formal way to give consent or withdraw it. Embracing this kind of contract has implications for good governance transparency and accountability. Generally speaking, the concept of the social contract explains the political governance of Oman and the limited elected institutions that influence decision making but does not help is to understand the democratic deficits in Oman or other GCC countries.

According to Al-Yousif (2008), the low-scoring of GCC countries, including Oman, on issues of governance and freedom are generally well-documented. However tackling them with reforms requires a political will. This will is constrained by the aim of their political survival so any reform would be limited so as not to challenge the position of the elites. The rulers also have more or less exclusive control over the oil wealth, and therefore control all of the avenues to change. Hence it is in their favor to keep governance institutions weak so as not to be stripped of power. Ross (2001) argues that with the absence of elected and strong economic institutions, the political elite were allowed to cultivate a patronage culture to utilize oil windfalls to buy loyalty and preserve power on all levels. For instance, Oman counted on royal patronage with tribal leaders and business elite exchange for high-ranking positions, government contracts, and state loans.

Governments in the majority of rentier state have reached an understanding that they have to reform or at least to appear responsive to people’s demands. However, with the oil revenue essentially in their pockets, they also realize that whatever reform they introduce currently, is more or less

up to them. In late-rentierism, rulers consider the importance of change given the new technological means and socioeconomic changes, but do not view it in the light of political development or openness. The neo-rentier oil states shifted their economic focus in response to globalization and other socio-economic pressure, which slightly not consistent with the first wave of RST where the state is almost isolated to other external forces. Despite government (rulers') realization that change is imperative for their sustainability and oil is finite, they fear that a lot of change may limit their control. This logic resulted in bad governance as mentioned above, which is reflected in constrained economic development that comes under pressure from internal and external forces.

7.1 Business Environment and FDI Impact on the Domestic Firms

This research tried to assess the general political and economic environment and how successful has Oman been in attracting FDI compared to other countries in the region, and is Oman an attractive destination for FDI?. Also, the research investigated whether inward FDI has contributed to the policy objectives of diversification, developing export performance and generating employment opportunities for the local workforce?

Findings:

The empirical evidence from both interviews and survey data found that Oman has a moderated business-friendly environment and that, overall, FDI has had a positive impact on Omani economic development, particularly in terms of contribution to GDP and export enhancement. However, FDI has not contributed strongly to two of Oman’s major policy goals, namely economic diversification and generation of employment for Omani nationals. Moreover, the study found that Oman attracted FDI from only a small number of

649 Hertog, S. Luciani, G. and Valeri, Dr Marc (2013) The Politics of Business in the Middle East After the Arab Spring, Hurst.

650 increasing population, unemployment

countries.\footnote{According to Information Centre, 85\% of all FDI stock in Oman in 2011 emanated from just nine countries: UK, USA, UAE, Kuwait, India, Qatar, The Netherlands, and Bahrain.} In contrast, the secondary data represent a different view in terms of the business environment, as demonstrated through reports published by credit rating agencies and major international institutions, particularly Global Competitiveness Report (2014) and Doing Business Report (2014), the report of the Global by the World Economic Forum and report of the most stable States. These reports indicate that Oman’s business environment has been declining in recent years. The disagreement between the secondary data with the primary data could be attributed to that the sample is unrepresentative in terms of opinions on the business environment. In simple terms, those who are very unhappy with the business environment, or who have not even thought of doing business in Oman, are not to be found in Oman. So one consequence of sampling only those who are in Oman is the bias is created towards those with reasonably favourable attitudes to the Oman business environment. Additionally, there may be reluctance to be too critical because they might fear damaging relations with the Omani government. But also, the secondary data is looking at things over longer time periods than participants in this research could talk about. In any case, they were not necessarily in a position to know the ‘big picture’; the participants could talk about their own experience but did not necessarily have the facts and figures which are available to economists or government statisticians. Statistics published by the Omani Centre of Information tend to confirm the other statistical evidence available in that FDI into Oman remains relatively modest and does not match the aspirations of the Omani government. Despite all efforts, Oman still does not manage to attract more than .02\% of FDI worldwide.\footnote{Kamal Mellahi & Cherif Guermat (2002), ‘What Motivates Foreign Direct Investment? The Case of Oman’. Paper number 02/01, School of Business and Economics, Exeter University,P3} This research argues that there are a wide range of opportunities in Oman for FDI but in order to successfully attract this FDI in greater quantities, and so use it as an enhancement tool for Omani manufacturing firms, both the Omani government and domestic firms in Oman must make much greater efforts. Some particular directions for such efforts are identified.
Discussion

The various theories in relation to FDI and development which have been discussed focused on the political and economic environment and pivotal role of government in making such environment appropriate, both for attracting FDI and encouraging productivity spillovers. The impact of FDI on host countries is not homogenous but rather depends upon country-specific conditions and policies, (e.g. Abramovitz, 1986; Cohen and Levinthal, 1990; Nelson and Phelps, 1966). The empirical studies established a consistent positive for developed countries and mixed evidence for developing countries.\(^{654}\) A more developed business environment in host country economy is associated with a high potential for spillovers.\(^{655}\) In the last two decades interest in FDI productivity has been stimulated for several reasons include a huge growth in the volume of FDI effected by globalization trend. FDI has become an important instrument for economic development. It has been used as a tool to solve some of the problems of local industries. Many countries, including Oman, rely on the expectation of productivity spillover to justify incentives packages given to foreign investors. It is time for the Omani government to strengthen its business environment and focus on building a strong private sector which could benefit most from this global trend and participate in solving some of the local challenges in terms of jobs creation and economic diversification. These findings support previous research into this important area which links productivity spillovers with appropriate business environment in the host country. (Balasubramanyam, Salisu and Sapsford 1996, and Moran 1998). In terms of sectorial distribution, FDI into Oman has been heavily skewed towards the oil sector and FDI has made a limited contribution to economic growth, export and employment generation in the non-oil sector. Consequently, FDI in Oman has made little contribution towards economic diversification away from oil, but rather has helped Oman to exploit its oil resources and generate high value added for the economy, mainly from the oil sector. Another characteristic of FDI in Oman is that it has predominately gone into those economic sectors

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\(^{654}\) Eswars S. Prasad, Kenneth Rogoff, Shang-Jin Wei, and M. Ayahan Kose (2003), Effects of Financial Globalization on Developing Countries, Some Empirical Evidence, IMF

\(^{655}\) Elsadig Musa Ahmed (2012), Are the FDI inflow spillover effects on Malaysia's economic growth input driven?, Elsevier B.V
which have the smallest proportions of Omani nationals in their workforce. If FDI is to make a strong contribution to employment generation for Omani nationals, it must be extended to other sectors such as trade, transport, storage and communication; real estate, health, fisheries, agriculture and education where the majority of private sector Omani employees work. The Global Competitiveness Report and Doing Business Report, and the report of the Global by the World Economic Forum, indicate that in terms of the business environment Oman could do a lot more to create an investment climate conducive to business efficiency. The reports identify that the six biggest impediments to business environment in Oman are: restrictive labour regulations; inadequately educated workforce; poor work ethic in national workforce; access to financing; inadequate supply of infrastructure and inefficient government bureaucracy. This resulted in a limited flow of FDI into the Omani economy, with Oman accounting for less than .02% of global FDI flows in both 2002 and 2011. This confirms the need, clearly identified in the literature (e.g. Moran 2007), for further improvements in making the business environment more attractive for FDI and more conducive for productivity spillovers.

Despite the remarkable achievements of Oman in such a short time span, the challenges facing the country are profound and real. The base of its current hydrocarbon sector is limited in scope. At present, proven oil reserves are estimated to last around 15 years at current level of production.656 Unless the economy is diversified in a meaningful way, the country will be heading for a major shock down the road. The shock could be experienced as early as a few years from now, should prices of oil collapse as they did in 2009 and the trend in spending continues to rise. The break-even-oil price, the price which the country needs to balance its budget, is estimated at $102 per barrel for 2014 and around $150 for 2020.657 These levels raise serious concerns given that the oil prices are projected to remain at best at their current nominal levels by 2020-levels which are already $20 per barrel below their pick in June 2014.

656 Minister of finance reflection notes on development performance and challenges of Oman, 2014
657 Oman Long Term Strategy (1996-2020), and The Mid Term Review of the 8th Development Plan, June 2014
Other challenges facing Oman are well known and reflected in various government documents. They include private sector based on privileges rather than competition; low level of productivity; high unemployment level and fragmented labor market; and widening non-hydrocarbon fiscal deficit putting fiscal sustainability at risk. The potential for FDI attraction is there. However, for this potential to be actualized the investment climate must be improved, the labor market reformed, and the education system needs to produce the skills needed. It is true that the country’s rankings have improved in the most recent business performance indicators, namely ease of doing business and competitiveness. However, there is still more to be done in several components of the indicators, namely innovation, market size, enforcement of contracts and protecting investors. Furthermore, the country still ranks low on the logistics performance index (62 out of 155), and there is a huge skill gap between what the education system produces and what the market demands. Reforms in these areas, coupled with the strengthening of institutions, will unleash the human capital potential, capitalizing on the country’s unique cultural heritage, geographical location, and other natural resource endowments.

7.2 Productivity Spillover Channels and Mechanisms

The interview and survey question related to this issue is how has FDI affected the productivity of domestic firm in manufacturing sector in Oman?

Findings

The current study found that FDI has a positive impact on productivity spillovers that contribute in upgrading and enhancing the performance of domestic firms through interaction with MNCs operations. However, the scope of the spillovers is limited. There are several possible explanations for limited

658 Oman Long Term Strategy (1996-2020), and The Mid Term Review of the 8th Development Plan, June 2014
660 In the 2014-15 Global Competitiveness Report Oman slipped by 13 positions in its ranking. It dropped from 33rd place to 46th place.
661 Education in Oman: the Drive for Quality (2013) and the Road Not Traveled: Education Reform in the Middles East and North Africa (2008.)
productivity spillovers. Firstly, weak absorptive capacity in the domestic firms. Secondly, having FDI focused in sectors such as Oil and Gas which have limited scope for productivity spillover.662 Thirdly, the relatively passive role of the government with regard to attracting FDI.

Discussion

One proxy for absorptive capacity in the literature is spending and investment in R&D. Our study found that the current level of research and development at both country and firm level does not support domestic firms to benefit from the presence of the MNCs. This was expressed clearly in most of the interviews:

‘R&D is something which we still have not really focused on widely in the country. There are some research and development centres but I think more and more that will be very important for the future’ (IO43) 663

‘Local companies I don’t think have got too much of facility because R & D requires both time and capital. So R & D is normally administered by big companies’. (IJV13) 664

In the survey, R&D was rated fourth important (mean 3.64) where 16.7% answered strongly agreed and 46.9% answered agree. In addition, the BTI 2014, Oman Country report p 21, “research institutes are nonexistence and R&D was evaluated at 0.1% of GDP in 2010. The Omani government has started to address this deficiency by creating a scientific research council”. 665

Similar findings in relation to level of R&D and extent of spillover have been supported by various studies for example, Kathuria (2000) on India and Kinoshita (2000) in Czech Republic found that investment in R&D by domestic firms was a necessary condition for spillovers to occur.666 Similar result were found by Halpern and Murakozy (2006), Abraham et al (2006), and Girma et al

662 Dunning (1979)  
663 Interview with an official, Senior Economist in the Central Bank of Oman.  
664 Interview with joint venture manufacturing firms in Muscat, General Manager (Operations), Reem Batteries & Power Appliances Co. SAOC.  
(2006). These studies argued that domestic firms with more advanced technology or R&D capability are likely to benefit more from the presence of foreign firms. In the same direction, Todo (2006) argues that the size of R&D of domestic firms is directly associated with extent of spillovers. Another measure of absorptive capacity is technology gap, which according to some interviewee is large between the domestic and MNCs firms. Also, according to table 5.7, the technology gap was rated last on the list of most important (mean 3.14) where 3% answered strongly agreed and 32% answered agree. This finding supported by previous studies, for example, Kokko, et al. (1996), found a positive and highly significant effect of MNCs presence on Uruguayan manufacturing firms with small technology gaps. In the same line of thought, some studies find that large technology gaps reduce positive spillovers. For example, Takii (2005) study in Indonesian, Borensztein, et al 1998, Kinoshita 2000, Keller and Yeapl (2003), Damijan et al (2003a), supported the idea that FDI can contribute to domestic productivity growth only if the technology gap between domestic and foreign firms is not too large and when a sufficient absorptive capacity is available in domestic firms. De Mello, (1999), and Xu, (2000), shows that the size of the technological gap between multinational and domestic firms should not exceed a threshold level.

The majority of inward FDI to Oman is resource-seeking FDI, and specifically, these investment inflows are in the oil and gas exploration business. The literature questions the benefits of this type of FDI (e.g. Dunning 1979). The finding related to sectorial composition consisted and productivity spillovers also, with Sinani and Meyer (2009) found that labour intensive MNCs generate larger spillovers in Estonia than equity intensive MNCs. Similar result were obtained by UNID, (2013) study on Sub-Saharan Africa, Dunning and Gugler, (2007) and Driffield (2001). This study found, also that many

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669 Amendolagine, V., Boly,A., Prota, F., Coniglio, N. and Seric, D. (2013), FDI and local linkages in developing countries: Evidence from Sub-Saharan Africa, UNIDO,
670 Dunning, J and Gugler,P. (2007), Foreign Direct Investment, Location and Competitiveness (Progress in International Business Research), EIBA,
issues need to be considered when enhancing productivity spillovers from MNCs to domestic firm. According to this research findings, these issues can be divided into three main levels. The first is related to the government in being the engine for this process in preparing the ground conditions for spillovers. This relies on the capacity of the government institutions to set the right policies and to ensure that these are implemented and enforced. The second relates to the domestic firms’ capacity and resources to learn from MNCs. The third is related to the MNCs in terms of which sector they operate in and the diversity of their countries of origin. These findings are consistent with some previous studies such as that of Yan Zhang and others with regard to emerging markets.\textsuperscript{672} Girma and Wakelin (2000) found that Japanese MNCs have the highest negative spillover impact on UK firms compared to the MNCs from USA. Also, Monastiriotis and Alegria, (2001), found that Greek MNCs provide larger positive spillovers on Bulgarian firms than those from other countries. Javorcik and Spatareanu (2010), found positive spillovers from American MNCs. This study produced results which corroborate the findings of a great deal of previous work in this field, that the impact of FDI on the domestic firms of developing countries, through productivity spillovers, is mixed for example Kinoshita & Chia-Hui, (2006); Navarette &Venables, (2004); Gorg & Greenaway, (2004). In order to have a better understanding of the extent of productivity spillovers in the Omani manufacturing sector, we now analyse our findings in relation to the main four channels for productivity spillovers which have been identified in previous studies.

\subsection{7.2.1 Labour mobility}

To assess the labour mobility channel being an effective channel for spillovers, the research poses these interview and survey questions: Are there any movements of workers between MNCs enterprises to domestically owned enterprises and vice versa/ Incentives for moving/ impact on the domestic enterprises/ Does MNCs assist the domestic enterprises in terms of types of training programmes to upgrade the human resource base on domestic firms?

\textsuperscript{672} Yan Zhang, Haiyang Li, Yu Li, Li-An Zhou, (2010), FDI spillovers in an emerging market: the role of foreign firms' country origin diversity and domestic firms' absorptive capacity, Journal: Strategic Management Journal.
Findings

On balance, interview and survey findings tended to support the view that the labour mobility channel has limited ability to enhance productivity spillovers in Omani manufacturing sector. This is due to the unique economic structure in terms of an excessively dominant public sector, and a weak and somewhat ineffective private sector. Moreover, the local firms are dominated by expatriates, who are typically employed on short-term contracts and so do not stay in the country for long. Furthermore, local human resources have a high degree of preference to work in a public sector job and see the private sector as a transit, creating a tendency not to learn new knowledge and skills. Another important finding was that the presence of MNCs had a negative impact on domestic firms by increasing the wages which incentivises the national workers to leave domestic companies to work with MNCs for better wages and image.

Discussion

Findings shown in Table 5.6 and Figure 5.13 show agreement with the statement that ‘there is movement of workers from domestic enterprises to MNCs’ 19.8% of respondents strongly agreed and 64.4% agreed with this item (mean agreement 3.98 on a scale of one to five where five represents strongest agreement). This means that most survey respondents agree that labour mobility in this direction is occurring but it does not tell us how much labour mobility they think is occurring. A similar view was emphasized by one interviewee, who stated:

‘In general Omaniis prefer to move from the local companies to the multinational companies. Why there are different reasons. One of the reason is because of the name, the brand’ (IF12). 673

This finding is consistent with major trends in the Omani labour market.674 Oman has a population of 3.6 million (of whom 1.53 million are non-national) but the private sector workforce is predominately foreign and according to official statistics, only about a third of employed Omanis are in the private

673 Interview with foreign firms in Duqm, General Manager in Crowne Plaza Duqm.
sector, which means that the majority of national human resource is tied to the government.\footnote{Chatham House Report in Omani Labour market (2014)} This is inconsistent with a number of studies which support the positive impact on labour mobility e.g. Blomstrom (several studies in Mexico) and Kokko (1996) on Mexico, Kokko et al. (1996) on Uruguay, Sjoholm (1999) on Indonesia, and Chuang & Lin (1999) on Taiwan.

The findings of the current research are consistent with research such as that of Lipsey and Sjohalm (2001) on Indonesia which found that presence of MNCs has a negative impact of FDI on domestic businesses where MNCs increase wages, which encourage employees of domestic firms to move to MNCs.\footnote{Lipsey R. and Sjomhalm, F. (2001), Foreign Direct Investment and Wages in Indonesian Manufacturing, NBER working paper no 0.8299, Cambridge, MA, National Bureau of Economic Research.} This study’s findings are consistent with Aitken and Harrison 1999, who argued that MNCs tend to keep domestic companies backward. Our study demonstrate this negative impact of MNCs, which in the case of Oman includes paying high wages to its employees in contrast to lower wages paid by local firms.

One of the practical contributions of this research is the development of a strategic framework for a business model that can be used by oil producing economies with similar economic structures to Oman. Such economies are characterized by two main challenges, each tending to block a major channel of productivity spillover. The first of these channels is the labour mobility channel - Oil producing economies like, Oman have a characteristic labour market structure whereby local firms are dominated by expatriates, who are typically employed on short-term contracts and so do not stay in the country for long. On the other hand, local human resources have a high degree of preference to work in a public sector job and see the private sector as a transit. Therefore there is a tendency not to learn new knowledge and skills.

7.2.2 Demonstration effect

The interview and survey question related to this is do domestic enterprises learn through observation and imitate the multinational corporations
by adapting their new technologies, marketing techniques, and types of products/ and is any effort being made by domestic enterprises in this regard?

**Findings**

This study found that the demonstration effect channel for spillovers is not effective in the Omani context. While local firms can in theory enhance their productivity through observation and imitation of MNCs activities, this tends not to happen in practice because the majority of local firms are small and they do not typically have the threshold or minimum requirement to learn effectively from MNCs.

**Discussion**

Although mixed opinions were found in the survey, the interview data clearly showed the limitation of this channel in enhancing productivity spillovers in Oman. Figure 5.12 shows positive opinion in form that 11.5% of respondents strongly agreed and 75% agreed that domestic enterprises learn through observation and imitate the multinational companies and, 38.5% strongly agreed and 45.5% agreed that effort is being made by domestic enterprises in terms of demonstrating new technologies and training workers in order to master the new technology. The majority of interviews, however, questioned the capability of domestic firms to use this channel, e.g.

‘.... spillovers depend on the ability of domestic companies to learn, stronger and bigger the more they can learn, in Oman local companies need to improve their own absorptive capacity’ (IF37).\(^{677}\)

As been clearly demonstrated in literature for example Cohen (2006), FDI investors have an incentive to prevent information leakage that would enhance the performance of their local competitors, however they may benefit from transferring knowledge to their local suppliers.\(^{678}\)

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\(^{677}\) Interview with foreign firms, Supply Chain Manager, Occidental Of Oman, Inc.

\(^{678}\) may have incentives to provide technical assistance to or share knowledge with their local firms particularly suppliers in order to improve and ensure the quality of the supply chain
7.2.3 Business linkages

The interview and survey question was ‘are there any business linkages between MNCs and domestic enterprises to improve their products or services in term of technology, management, marketing techniques, best practice and skill?’

Findings

This research found that business linkages were not strong in Oman. This was confirmed by the survey and interviews. The majority of policy makers considered that more could be done to improve business linkages. Although there is good interaction between domestic firms and MNC, local investors were clearly unsatisfied with the level of business linkages and the majority of foreign investors said that the extent of business linkages was not strong because domestic firms lack the capability to link with them. This is not a surprising finding, as building business linkages is a stated objective of all government dealing with business, although they rarely do it in practice. In addition, foreign investors tended to mention that as marketing tools and part of social responsibility, while domestic firms would always want more linkages to increase the business although they could lack the capability. In the survey, as illustrated in table 5.4 and figure 5.10, indirect linkages with local competitors through demonstration effect and labour mobility(both channels not effective in Oman context), with a mean of 3.98, was considered a common form of business linkages; 11.5% of respondents strongly agreed and 77% agreed.

Discussion

The literature acknowledges that linkages are prerequisites for spillovers and are beneficial for domestic firms even if there are no spillovers. In this respect, the study found that both types of linkages, backward and forward linkages, exist in Oman on a small scale. This is attributed to weak absorptive capacity of and ineffective domestic firms which the counterpart with MNCs. This is demonstrated in our empirical evidence and international reports.

There is a real need for domestic firms to be upgraded through MNCs providing

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a useful features through the Spillover. Strong support was found in the literature business linkages, as demonstrated by Lall (1980), MNCs may have incentives to provide technical assistance to or share knowledge with their local firms particularly suppliers in order to improve and ensure the quality of the supply chain. This is also confirmed by Crespo and Fontoura (2007). The absorptive capacity of domestic firms is important as they need some minimum knowledge in order to be able to introduce the changes suggested by foreign affiliates in downstream sectors. Smarzynska (2002), with regard to Lithuania, argued that there are spillovers from FDI taking place through backward linkages. Also, Rodriguez-Clare (1996) develops a formal model of linkages and show that multinationals improve welfare only if they generate linkages over and beyond those generated by the local firms they displace. Moreover, Bessonova, et al. (2002) in Russia found that FDI improves the productivity of domestic firms through backward linkages. In related findings, the literature support the view that company size is important for productivity linkages, because the size reflect on the capability to learn, the bigger and stronger, they are the better they can learn MNCs, this is in line with the findings of Ornaghi (2004), and Yan Zhang. Similar views was emphasized in one of interviews

'Omanis local companies need to improve their own absorptive capacity' (IF37).

7.2.4 Competition

The interview and survey question was Do MNCs enterprises compete with domestic enterprises?

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683 Bessonove E et al (2002), Trade Liberalization, Foreign Direct Investment and Productivity of Russian Firms, CEFIR, Conference
686 Interview with foreign firms, Supply Chain Manager, Occidental Of Oman, Inc.
Findings

The result of this study indicated that there are mixed opinions regarding whether MNCs compete with domestic enterprises. The survey data found that a majority agreed that MNCs do compete with domestic enterprises (15.6% strongly agreed and 54.2% agreed that MNCs compete with domestic firms).\(^{687}\) Also, mixed opinions were found from interviews. The study showed both positive and negative effects in relation to competition.

Discussion

This findings are in line with previous studies,\(^{688}\) which found that MNCs were more productive than the local incumbents. It is rational to expect that the entry of foreign owned firms into a specific market will result in some local firms ceasing their production or losing some market share. However, competition could have a positive effect on the local firms remaining in the market due to the need for them to innovate and develop more efficient production techniques. Our findings on the relation between lack of knowledge on the exact mechanisms through which FDI spillovers occur, and on how spillovers actually take place, on the process of spilling-over been supported in previous studies by Gõrg and Strobel (2001), Griffith, and Redding and Simpson (2004).

7.3 Conditional Factors for Productivity Spillovers Enhancement

The interview and survey research question in this area was: Which factors are key determinants of spillover from MNCs that may influence linkage formation in Oman manufacturing sector/ and respondents’ level of satisfaction with quality of these factors.

Findings

Unlike other findings in this study, where we found positive agreement in the area, the findings from both the empirical chapter and secondary data

\(^{687}\) A large majority (about 70%) agreed or strongly agreed that MNCs compete with domestic firms.

including the SOWT analysis suggested the precondition factors for productivity spillovers enhancement were negative and unsatisfactory in almost all the areas, with the possible exception of the infrastructure.\textsuperscript{689} This could explain the limited achievement in productivity spillovers in Oman.

Discussion

This study found that the limited productivity spillovers in the Omani manufacturing sector are linked to weakness in the key factors for productivity spillovers to accrue which include national human resources, institutional arrangement and domestic firms’ capability. Therefore, as has been well demonstrated in the literature, using FDI to upgrade domestic manufacturing does not come easily or naturally but rather depends on how governments put together reform packages that may include investment promotion, skilled worker training and labour market flexibility.\textsuperscript{690} This finding has strong support from numerous studies (Dunning 1993, Cave 1982, Buckley, Chengqi, Jeremy, Chen and Ku, 2005, Fry 1992a; Borensztein et al., 1998; Bosworth and Collins, 1999; De Mello, 1999; Agosin and Mayer, 2000; Lipsey, 2000, Moran, 1998) which found that FDI influence on the domestic firms depends to a large extent on host country conditions and the type of FDI inflows. The positive effects of MNCs on productivity of domestic firms depend on certain preconditions. For example, the World Bank’s 2001 edition of global development finance talks about the importance of absorptive capacities.\textsuperscript{691} Also, Meyer and Sinani (2005), through meta-analysis demonstrate that FDI does generate positive spillovers under certain circumstances.\textsuperscript{692} Our study findings agreed with existing literature in that FDI need must not only be attracted but more importantly must to be integrated in the host economy business cycle particularly with regard to domestic firms.\textsuperscript{693}

\textsuperscript{689} Oman since oil discovery has spent heavily on upgrading its infrastructures.

\textsuperscript{690} Moran (2008)

\textsuperscript{691} WB study found that the impacts of FDI depend on the industry, as well as host country policies.

\textsuperscript{692} These circumstances are related to local firms’ motivation and capability to react to foreign entry, which are grounded in their human capital and the institutional framework.

7.3.1 Human capital

This study found that national human resources are crucial elements for productivity spillovers to accrue. This was demonstrated in our empirical chapters. In interviews, the point was stressed by local investors stating:

‘Omanis prefer to wait for public jobs instead of working in private sector’ (IO30).

Also, we found from the survey, as shown in Table 5.7 and Figure 5.15 the second most important factor after institutional framework was Human Capital (mean 3.92) where 18.8% strongly agreed and 62.5% agreed,. In fact, Oman’s labour market is characterised by three main disadvantages for productivity spillovers. Firstly small young population which tend to prefer to accept government jobs. Secondly, domestic firms dominated by expatriates, while more emphasised needed on national human resource to ensure the continuation of knowledge in the country not expatriate who stay for a short time. Thirdly, there is a skill mismatch between national job seekers and the requirements of domestic firms. According to a recent report by the World Economic Forum, the main three obstacles for doing business in Oman are related to the human resource. Our findings stressed the importance of human capital as one of the most important aspects for potentially positive productivity spillovers to accrue. This has been supported widely by numerous studies example e.g., Borensztein et al (1998), using data from 69 developing countries over the last two decades suggest that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. However, the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital. In the same vein, Hoppe (2005) argued that human capital is the most important for the absorption capacity. Both elements concern human resources a sufficient

694 Interview with an official, director General of Rusayl Industrial Estate, Public Establishment for Industrial Estates.


696 Adequate national workforce, responsible work ethic

697 in terms of quantity and quality

698 Borensztein, De Gregorio and Lee (1998), How does foreign direct investment affect economic growth?, Journal of International Economics, 45 115 –135; P117
number and quality of qualified human capital are important in the host country. Moreover, Meyer (2004) points out that productivity spillovers might happen through the human resources market, because local trained employees of the MNCs might move to local suppliers, and hence, the transfer of proprietary knowledge is expected to occur. Another possibility is that qualified employees might choose the entrepreneurship path and pursue their own businesses through MNEs outsourcing arrangements, see Figure no (7.1). This study adds to the existing literature further elements in this dimension, where the majority of employees- 85% of the total work force in the private sector- are expatriate. Also, there is a reluctance of qualified national work force to joint domestic firms and they prefer to work in the public sector.

**Figure: 7.1 Human Resource and MNCs Interaction**

![Diagram of Human Resource and MNCs Interaction]

Source: Compiled by author

### 7.3.2 Domestic firms’ capability

The study found that one of the main reasons for limited productivity spillovers is the degree of readiness of domestic enterprises which are the main players and the counterparts of MNCs. In simple terms, the idea is that when FDI come to the host economy, the domestic enterprises must have the

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699 Borensztein et al., (1998)

700 Statistical year book (2013)
capability to utilise the opportunity to observe what MNCs are doing and learn from their practices. In this way they create strategies to create their own advantages and enhance their productivity. Indeed, although government policy is important to determine patterns of FDI inflows, domestic enterprises are central to taking advantage of the FDI once it materialises and thereby enhancing the productivity spillovers and benefits from MNCs operating domestically. Our findings showed a dissatisfaction with domestic enterprises’ ability to do this. This finding might be expected in a country characterised by the Dutch disease and domination by the public sector. In the survey, 33% of respondents had a low level of satisfaction and 4% a very low level of satisfaction about the quality and readiness of domestic enterprises to benefit from the presence of MNCs. Similar findings were obtained from interviews and secondary data. The same point was stressed by one interviewee stating:

‘.... spillovers depend on the ability of domestic companies to learn, stronger and bigger the more they can learn, in Oman local companies need to improve their own absorptive capacity’ (IF37). 701

These findings are consistent with other findings, particularly in developing countries. For example, previous studies by Aitken and Harrison (1997); Blalock and Gertler (2005a); 702 and Javorcik (2004), suggest that there is little evidence of spillovers from foreign invested firms to domestic firms in developing countries. The spillover effects on productivity from these channels depend crucially on capacity of domestic firms to build industrial linkage. For example, Moran (1998), in his book Foreign Direct Investment and Development, emphasised that using FDI to upgrade and diversify production in the manufacturing sector required a strong enterprise that can work with government in implementing the reform packages.

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701 Interview with foreign Oil and gas firms in Muscat, Supply Chain Manager, Occidental Of Oman, Inc.
7.3.3 Institutional framework

One important finding was the link between the limited sizes of productivity spillovers in the Omani manufacturing sector and ineffective institutional arrangements. This finding was confirmed by the three modes of data collection and could explain the slow progress in the national agenda of diversification and moving toward private sector lead growth. As shown in Table 5.7 and Figure 5.15 institutional framework has the highest mean (4.41) and was considered the most important factor for spillovers. 50% of respondents strongly agreed and 43.8% agreed on the importance of this item. In Oman FDI organisations are scattered among different agencies, which include the authority for Investment Promotion and Export Development, Oman Chamber of Commerce and Industry, Knowledge Oasis Muscat, Oman Oil Company, Takamul in Investment Company, Oman Company for Tourism Development (OMRAN), Salalah Free Zone Company, Public Establishment for Industrial Estates, Sohar Industrial Port Company, Duqm authority and Ministry of Foreign affairs. According to our findings the level of coordination among themselves as well as with domestic and foreign firms is low. In addition, unlike many other countries (e.g. in Singapore, Mexico) there are no institutions which are dedicated to the enhancement of productivity spillovers. Such a body is vital to ensure that the systems are functioning in the right way to achieve the productivity spillovers objective - realisation of this objective will not occur automatically.\(^{703}\) One official interviewee demonstrated this point by saying:

‘We have different government bodies, but we don’t have a tool for that. There is Ministry of Foreign Affairs, Ministry of Commercial Industrial, Oman Chamber of Commerce, and Public Establishment of Industrial State. But none of them focus on building relations between foreign companies and local companies’.\(^{704}\)

Our findings are well supported in the literature for example, according to Alfaro et al. (2004), in developing countries institutional arrangements are central to enhancing productivity spillovers and weak institutional capacity is likely to have a substantial negative effect. The institutional importance is also


\(^{704}\) Interview with an official, Director General of Research & E-Services, Public Authority for Investment Promotion & Export Development.
supported by Acemoglu and Robinson (2012), who in their book ‘Why Nations fail’ consider that the main reason for the success and failure of a nation is attributed to its institutions.\textsuperscript{705} Also, our findings in this are consistent with Agosin and Mayer 2000, who argue that some countries (mainly Asian tigers) have been successful in adopting screening policies to ensure that FDI does not displace domestic enterprises or that MNCs bring in new technologies or introduce new products to the country’s export basket. Most developing countries, however, do not have the administrative capabilities to implement effective screening policies.

\textbf{7.4 Effectiveness of Policy Instruments and Platforms}

This study found that government interventions (putting in a place proper policies and enforcement tools) are essential for creating an environment that is conducive to productivity spillovers. According to several UNCTAD, World Investment Reports, there is a need for governments to actively promote the creation and deepening of linkages between FDI and local industry. Markets may fail to create efficient linkages, raising the cost to both parties of entering into long-term supply relationships and reducing the ability of domestic firms to become competitive suppliers. This is also supported by Jensen (2006), who argues that government through its institutions affects policies, and policies affect multinational operations.\textsuperscript{706} Also, Lipsey, (2002) suggests that positive impact will be only under certain local policy conditions\textsuperscript{707} According to Rodrik (1999) the policy literature is filled with extravagant claims about positive spillovers to domestic firms. Wells (1998), argues that some FDI is good; almost certainly some is harmful.\textsuperscript{708} But exactly what kind of investment falls in each category is very difficult to determine, even if the effects are measured against only economic criteria. Economic performance necessitates policy change in a world of dynamic political and economic conditions. In the global


\textsuperscript{706} Nathan M. Jensen (2006), Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment, Princeton University Press.


\textsuperscript{708} Wells (1998), Multinational and development countries, Journal of International Business Studies, 29 (1), 101-114
economy, governments must make adjustments to economic policies according to the domestic economic situation and negotiate with other MNCs for mutual benefits. For institutions to have value, they must allow for the policy flexibility required for changing economic conditions. Based on findings from primary and secondary data, figure 7.2 presents some important roles for the host government for productivity spillovers to materialise.

**Figure 7.2: The Role of Government based on research findings**

<table>
<thead>
<tr>
<th>Oman economy objectives to acquire</th>
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<tbody>
<tr>
<td>• Capital and jobs</td>
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<tr>
<td>• Technology, production, and R&amp;D skills</td>
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<tr>
<td>• Organizational and managerial skills</td>
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<td>• Marketing and exporting skills</td>
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<tr>
<th>Objectives of FDI policy</th>
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<tr>
<td>• Technology transfer and diffusion</td>
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<td>• Save foreign exchange</td>
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<td>• National independence</td>
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<td>• Priority sectors</td>
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<td>• employment creation</td>
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<td>• Avoid concentration</td>
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<td>• Diversification</td>
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<td>• Local content</td>
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<td>• Export promotion</td>
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<td>• Advancement of Omanis</td>
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<tr>
<td>• Local R&amp;D</td>
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<tr>
<td>• Regional development</td>
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<tr>
<td>• Capacity utilization</td>
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Source: Compiled by author

In his book, economics, but not as you know it, Ha-Joon Chang (2002) showed that Singapore is a good example of the role of government in enhancing productivity spillovers. Singaporean companies succeed in effectively utilising the inward FDI, improving their productivity and compet internationally.\(^709\) In fact, the Singaporean example is relevant to Oman as the government plays a vital role in economic activities in both countries. An interesting finding from secondary data is that emerging economies that have succeeded in attracting substantial amount of foreign investments such as

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\(^709\) Ha-Joon Chang's(2013), Economics, But Not as You Know It, University of Cambridge,
those of South Korea and Taiwan, represent a model of industrial economy while Singapore and Hong Kong represent a model of service economy. Despite the large differences between these models, they share some general features such as government intervention in directing national economy path, clarity and stability of investment policies, support for domestic business activities. The programmes of those countries were focused on three key elements: (i) increasing flexibility and attractiveness of policies and legislations related to FDI; (ii) development of incentive packages that link with productivity spillover; and (iii) enhancing the investment environment. Another important aspect of the role of government which could be among the reasons for the slow progress of productivity spillovers from MNCs to domestic firms in Oman is attributable to the relations between government, business and society and, equally important, lack of functional institutions to lead private sector transformation. Our findings confirm that there are a clear signs of a performance problem with private sector development in Oman, as a result of some fundamental impediments as everything is connected and matters for private sector growth. However, understanding and addressing the existing concerns requires an in-depth coordination between the three pillars: government, business and society to ensure a win-win situation is achieved. Moreover, private sector development is a multi-sectorial challenge. Indeed, it is crucial for private sector led growth to remove conflicts of interest between politicians and business people. Having said that, there is an urgent need to tackle typical barriers facing private sector growth and recognize what determines this growth. This includes dealing with genuine problems in all production factors, including capital, labour and institutions, and strengthening absorptive capacity. The culture of doing business in Oman must also be considered. In fact, to meet the above challenges is not an easy task; it requires development of multiple institutions associated with finance, labour, regulation, and trade, as well as the accumulation of production, quality and marketing know-how by firms and workers. The dilemma is to create the

710 Xiaolun Sun.(2002)  
711 In state business relation, Loyalty and alignment of interests is critical, as soon as personal agendas are involved, efficiency will be affected.  
712 Mark Valeri (2014), Oman: Politics and Society in the Qaboos State, C Hurst & Co Publishers,  
balance among them. In light of the expected depletion of oil and gas reserves, Oman will need to develop other sources of value-added through the private sector.\textsuperscript{714} In addition, Oman saving and investment balance is characterized by interesting features which affect to some extent the importance of the best utilization of FDI. These features include; Oman’s suffers from low saving propensity and subsequently limited domestic investments; the financial institutions in Oman do not channel savings in accordance with the needs of productive investment, which is essential in achieving long-term growth; the private investment is not satisfactory in fact weak; and the national savings are less than domestic savings due to expatriate labour remittances and interest and dividend paid on external liabilities.\textsuperscript{715} In addition, public investment dominates over private investment. This is reflected by the fact that the relative share of public capital formation in gross capital formation, the recent increase in domestic savings has not necessarily been contributing to financial sector development, because private savings remain low - link with increase in oil price- and finally, the private saving rates hovered at 5 percent on average from 2002 to 2011. This low private savings rate is unusual in a country with a high-income level when income and saving have a strong positive relationship.

7.4.1 Aspects of policy that influence productivity spillovers

The Government in Oman, as in other "rentier" economies tries to develop private sector to play more active role in economic activities,\textsuperscript{716} considering that the local economy is based in most cases on imported products and services and any local production is good for the economy. It generates employment for local people, and taxes for government, and diversifies the economic base. This is of particular importance in the case of Oman as the economy is dominated by oil and the government sector. In 2013, the oil sector still accounted for 39% of GDP, about 86% of government revenues and 66% of export earnings.\textsuperscript{717} As a result, economic growth has been strongly correlated with changes in oil prices.

\textsuperscript{714} Find way to disconnect the clear relation between government spending and rest of the economy
\textsuperscript{715} Central Bank of Oman (2013), Annual Report,
\textsuperscript{717} Central Bank of Oman, Annual Report, 2013
Oman, however, does not have the immense oil reserves of its Gulf neighbours. Its total proven reserves are relatively modest at about 5.1 billion barrels. In addition, Oman’s geology makes production and extraction costly. Oman is becoming more active in its efforts to integrate domestic companies into the global chain, through local capacity building and investment promotion activities. Although there are a lot of policies aspects begin mentioned in the literature and during the field visits, will limit the discussion to the main policies that influence productivity spillovers, which include ownership structure, clusters, State Owned Enterprises, Free Zones, Investment Map, and Local content.

7.4.1.1 Ownership structure and mode of entry

In terms of mode of entry or ownership structure, this study found that in the Omani context joint ventures (JVs) are more suitable in relation to enhancement of productivity spillovers in manufacturing firms. This is attributed to the advantages offered to both parties. For example, the domestic firms can benefits from different productivity spillovers features from MNCs and utilized their long experience in doing business, adapted in a way that suits local condition and ensures the success of the JV. This will help them to expand and play a significant role in sustainable growth and prosperity. Also, for FDI investors having a local partnership will reduce cost, and enhance access to local assets and local market demand because the local partner understands the market and can provide competent management at all levels. This finding is consistent with great literature in developing countries, for example, Smeet and de Vaal, (2005) as illustrated in Table (7.3) which presents the different types of FDI and the associated spillover channels. It is evident from the table that a joint venture has the highest potential for spillovers through the three main channels of productivity spillovers.

719 Nuno Crespo and Maria Paula Fontoura (2010), Determinant of Factors of Spillovers, what we really know, Lisboa
720 Market forces not going to work because domestic firms are not competent
Table: 7.1 FDI Form and Spillover Channel

<table>
<thead>
<tr>
<th>Channel</th>
<th>Licensing</th>
<th>Joint Venture</th>
<th>Full Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demonstration effects</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Labour Mobility</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Business Linkages</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Smeets and de Vaal, 2005; P 8

In addition, Beata Javorcik argued that positive productivity spillover from FDI to local firms are associated with projects sharing domestic and forging ownership but not with fully owned foreign investment enterprise. 722

7.4.1.2 Clusters:

As demonstrated in the earlier chapters, there are three business clusters in Oman. The first is related to oil and gas, which is a well organised sector and the government invests heavily in both human resources and its infrastructure. Further according to a recent World Bank report, Oman is the only country applying three unique techniques in enhanced oil recovery (EOR), 723 which is very attractive to MNC, as it can be used in other oil producer countries when they reach Omani conditions. The second is Muscat Oasis, which focuses only on IT related companies and is available in the capital Muscat, with limited places for new companies. Thirdly, there are the industrial estates which focus on manufacturing. There is strong support in the literature for using clusters to create a proper business environment particularly for SMEs. For example, Lucas (1991), 724 Rodriguez–clare (1996), 725 and Yehoue, in his 2005 IMF

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724 Lucas, Robert E. Jr, 1990, Why Doesn’t Capital flow from rich to poor countries, American Review, Vol.80, No 2

725 Rodriguez –Clare, 1996, Multinationals Linkages and economic development, American Review, Vol.86, No 4
working paper, explained how a combination of setting up a cluster and implementing policy reforms will be a key for attracting FDI and enhance productivity spillovers and linkages.\textsuperscript{726}

7.4.1.3 State Owned enterprises:

With an objective of increasing sustainable development, SOEs have been employed as anchors of national industrialisation and act as a bridge between MNCs and domestic firms. Improvements to the operational efficiency of SOEs will allow the ‘crowding in’ of the private sector through the development of the industry. Oman currently has around 65 SOEs distributed among different sector.\textsuperscript{727} SOEs played an important role in opening the door to other domestic firms which do not have the capability and expertise. According to our findings, in the case of Oman, SOEs have failed to achieve this objective. The objective must not be left to market forces to decide.\textsuperscript{726} There is strong support in the literature particularly in developing countries for example, Alec Zuo, and David K. Round, 2012.\textsuperscript{729} Girma, 2008, argued that SOEs can play a significant role to help domestic firms and enhance productivity. Also, SOEs, played an important role in chains to best utilise inward FDI. However, policy makers involved in the SOEs should ensure that managers have the right incentives to make long-term investment in absorptive capacity development.\textsuperscript{730} Also, according to Rodrik, SOEs played a very important role in enhancing the productivity and profitability of domestic firms in both Taiwan and South Korea, by ensuring that key inputs were available locally for private producers in downstream.\textsuperscript{731}

\begin{itemize}
\item \textsuperscript{726} Yehoue, Etienne B. (2005), Clusters as a Driving Engine for FDI, IMF Working Paper No. 05/193
\item \textsuperscript{727} Ministry of Finance website
\item \textsuperscript{728} Rodrik, Dani. (1995a), "Getting Interventions Right: How South Korea and Taiwan Grew Rich." Economic Policy, , (20), pp. 53-97.
\item \textsuperscript{729} Alec Zuo, David K. Round(2012), The impact of foreign direct investment on domestic supplier industries within Chinese provinces, Journal of the Asia Pacific Economy, 17(3):383-398
\item \textsuperscript{731} Rodrik, Dani(1995a), "Getting Interventions Right: How South Korea and Taiwan Grew Rich." Economic Policy, (20), pp. 53-97.
\end{itemize}
7.4.1.4 Free Zones:

The Free Zones trend is common in the Gulf region and a lot of countries succeed in using this tool to enhance productively spillovers from MNCs to domestic firms, e.g. UAE and Saudi Arabia.732 There is partial support in literature for free zones. For example, Ewe-Ghee Lim, 2001 suggest that market size, infrastructure quality, and free zones are important for FDI and development.733 According to the World Bank, using free zones as instruments for encouraging economic development has only limited impact on productivity spillovers and only under certain conditions, including appropriate setup and good management. The World Bank argues that a better policy choice is to liberalize a country's entire economy.734 Also, Blomström, Kokko, and Mucchielli, (2003), found positive impact between free zones incentives and productivity spillovers.735 Also, F Abraham, Konings, (2010), argued that FDI spillovers in the Chinese manufacturing sector depends on the structure and origin of foreign ownership, the export status of firms and the characteristics of the special economic zones firms are operating in.736

7.4.1.5 Investment map:

In order to move to private sector led growth, the government must search for a local or foreign investment to achieve its planned goals, but investment must be planned, as random investment could cause a lot of problems. All projects prepared by the investor or international agencies take only individual profitability into account. However, local macro interests (economic, social, etc.) should also be taken into account. A task for government is to prepare an investment map where projects are ranked according to priority from each country’s viewpoint. Investors choose freely and government support (interest,  

732 Gulf's free zones help spur economic diversification, for example Jebel Ali zone in Dubia, accounts for 20 per cent of overall foreign direct investment (FDI) into the UAE and more than 50 per cent of Dubai’s total exports.
733 Ewe-Ghee Lim, Determinants Of, and the Relation Between, Foreign Direct Investment and Growth: A Summary of the Recent Literature, International Monetary Fund, 2001
734 The World Bank
735 M Blomström, A Kokko, JL Mucchielli, 2003, the economics of foreign direct investment incentives, Springer
736 F Abraham, J Konings, 2010, FDI spillovers in the Chinese manufacturing sector, Wiley
tax relief, subsidy, etc) will vary according to the project’s priority on the map. The location of the natural resources and materials must be incorporated in an investment map in order for provincial investment projects to be located close to sources of raw material. The investment map can involve the estimation and location of raw materials by conducting exploration and research studies and establishing the most suitable methods for securing the sustainability of these materials. This finding is consistent with Dunning’s (1979) theory, which argues that companies usually target natural resources that are available in huge quantities in the host country. Oman has been blessed with abundant national resources, which according to our findings have not been best utilised as the private sector is underperforming by failing to use these resources effectively.

7.4.1.6 Local content initiative:

Oman adopted the local content requirement (ICR) recently in 2010 and it is limited to the oil and gas sector. There are mixed opinions in the literature about whether this is likely to be useful or not in the long run. This initiative applies in a lot of countries, mainly developing countries, producing primary resources. For example, the global oil and gas industry association for environmental and social issues, acknowledges that ICR is essential for social responsibility, which could be reflected in transfer of productivity from MNCs to domestic firms. However, there is an opposite opinion, that it is difficult run cost and benefits analysis for ICR, and for LCR to be useful it must be applied in a specific economic structure where a wide range of suppliers are available and the base of the economy is diverse enough and not relying on imports to fulfill its needs. A recent study by Gary Hufbauer, Schott, and Cimino, titled, “Local Content Requirements: A Global Problem”, published by Peterson Institute in 2013, argued that LCR are a bad policy which affects the competitiveness of the country and industry. Also it is a kind of protectionist policy, which is in conflict with WTO rules. They argued that there are other more useful policies such as use of mixed policies of subsidy, tariff, tax exemption and other transparency policies that encourage a business-friendly

737 The global oil and gas industry association for environmental and social issues, local content strategy, a guidance document for oil and gas industry, 2011
However, according to our findings there is limited success in these aspects of the policies and programmes in the context of Oman, because they are managed by a small team working in an isolated manner and they are overloaded with many other top priorities in day-to-day activities. Second, it has been applied on a small scale for example, the knowledge Oasis is limited to IT and LCR is limited to the Oil and Gas sector. In addition, the limited capacity of these initiatives does not permit them to have a desirable impact in overall economy or to make necessary changes in the landscape of the business activity in Oman. According to Agosin and Mayer (2000), some countries (mainly the Asian tigers) have been successful in adopting screening policies to ensure that FDI does not displace domestic enterprises or that MNCs bring in new technologies or introduce new products to the country’s export basket. Most developing countries, however do not have the administrative capabilities to implement effective screening policies.

7.5 Chapter Summary

This study aims to assess how successful Oman has been in using FDI as instrument for the enhancement of productivity of manufacturing firms. In order to achieve this aim, the researcher use a combination of research methods that included qualitative (42 semi structured), and quantitative (a survey with 96 completed questionnaires) as well as secondary data from various publication from government and regional and international organization. Before moving to the findings of the study, it is essential to understand that Oman is a developing oil producing economy characterized by a number of specific structural economic features, including a high dependency on hydrocarbons as expressed in the share in oil and gas revenues from export and the share of the hydrocarbon sector in GDP and a young and rapidly growing national labour force; and the heavy reliance on expatriate labour in the private sector. These features pose structural policy challenges to Oman, notably economic diversification and in the areas of education resulting in the lack of employment.

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738 Gary Clyde Hufbauer, Jeffrey J. Schott, and Cathleen Cimino (2013), Local Content Requirements: A Global Problem, Peterson Institute,

739 It connected different crossing interest from different stakeholders, MNCs and profit, host country and economic development and domestic firms and infant industry, which interact with each other directly or indirectly.
for locals while creating huge demand for the foreign labour and sustaining the same level of economic growth.

**Figure: 7.3 FDI and the Private Sector Interaction Components based on Omani context**

![Diagram illustrating FDI and the Private Sector Interaction Components based on Omani context.]

Source: Compiled by author/ the order of the productivity features was based on the mean in our questionnaires (more frequent)

This study found that Oman has a limited degree of success in using FDI as a tool to enhance productivity spillovers of manufacturing firms, this due to two major overall economic structure problem which can be categorized into factors related to the Dutch disease, whereby the public sector in an Oil economy (rentier state) government plays a dominant role in the economy, and the source of job creation, income, investment and services and because they receive a huge income from oil, leaving no incentive for the government to focus on developing other sectors including the private sector. This situation encourages local human resources to prefer to work in the public sector because of salaries, status, and comfort). In addition, there are factors related to the organization of domestic business, which are scattered in small units, and there performance relies heavily on government spending and they enjoy the privilege of getting subsidized inputs (energy and utilities). This results in there not being able to compete in the International market and negotiate with
government to have more conducive policies toward doing business. These two major problems result in limiting the success of Oman realizing the benefits from FDI in enhancing productivity spillovers. This is attributed to several reasons, which include: First, in terms of the four channels of productivity spillovers identified in the literature, two of them are not functioning. The labour mobility channel does not function because national human resources prefer to work in the public sector and are reluctant to work in domestic firms, which are 85% dominated by expatriates who are available for a period of time only. Also, the demonstration effects channel, which helps domestic firms to observe and learn from MNCs, is not strong due to weak capability and shortage of resources of the domestic firms. As for the business linkages channel, the impact was not strong because it was not institutionalized and it has left to market forces to build business linkages. For the last channel, competition, the study indicated that there is mixed evidence, it showed both positive and negative effects in relation to MNCs competition for domestic firms. Second, the key factors required for productivity enhancements are weak or not available or not effective enough, these include the human resource, institutions and capability of domestic firms, as discussed earlier. In addition, there are no proper institutional arrangements which address the productivity agenda and coordinate the efforts between the stockholders. Thirdly, in terms of policies, although there are good policies in place in the form of LCR, clusters, and free zones, their impact is limited because they apply to specific sectors, and are limited in scale and are managed by government technocrats, who are busy. Fourthly, in terms of the nature of FDI, Oman attracts a very small volume of FDI compare with its potential, and attracts the wrong type of FDI concentrated in the Oil and Gas which has limited productivity spillovers. It attracts FDI from few countries, which limited the diversity of the technology, experiences, know-how and other features that domestic firms can benefits from. The study findings are consistent with the empirical literature on the relationship between FDI and productivity of domestic firms in developing economies, which is mixed.

740 According to Centre of Information in 2011, 80% of FDI inflow came from 11 countries

741 Whereas some authors find positive and significant productivity gains induced by the presence of foreign-owned enterprises, some others find insignificant or even negative effects in the hosting economy.
theory by Dunning (1993), Vernon’s product life cycle theory (PLC) and new growth theory can explain a theoretical link between them. They all argue that FDI has an influence on the local private sector, but the direction of the influence is not certain.\textsuperscript{742} According to Cave’s (1982) and Dunning’s (1993) views, inward FDI has had a positive impact on the local private sector and strengthened domestic enterprises, through efficiency spillovers to local firms\textsuperscript{743}, capital accumulation, transfer of know-how\textsuperscript{744}, skills and best practice and job creation; technological capacity building, and opening of export markets, which all provide arrangements that increase the potential of the host economy. In contrast, some theorists such as Veron (1971) and Jenkins (1987) predict that MNCs may intensify competition and dominate the market resulting in crowding out small and medium domestic enterprises (SME)\textsuperscript{745}, and have a negative impact on economic development. Our study agrees on some negative impact of MNCs which in the case of Oman include paying high wages to their employees in contrast to lower wages paid by local firms. Some others, including Lipsy (2002) and the UN (2006) suggest that the positive impact of FDI will only apply under certain local policy conditions\textsuperscript{746} and absorptive capacity\textsuperscript{747, 748}. Also, Meyer and Sinani (2008) demonstrate through meta-analysis that FDI does generate positive spillovers under certain circumstances. They argued that the prime driving forces are local firms’ motivation and capability to react to foreign entry, which are grounded in their human capital and the institutional framework. Likewise, Cohen argues in his book MNC and FDI that behaviour and the effects of FDI are complex: “it depends”.\textsuperscript{749}


\textsuperscript{743} Buckley, Wangb, and Clegg (2007), The impact of foreign ownership, local ownership and industry characteristics on spillover benefits from foreign direct investment in China, Centre for International Business, International Business Review 16 142–158; P.142

\textsuperscript{744} Chen and Ku, 2005; P.109


\textsuperscript{746} Lipsey, (2002); PP, 40-47

\textsuperscript{747} Also, the World Bank’s 2001 edition of global development finance talks about the importance of “absorptive capacities”

\textsuperscript{748} United Nations, (2006), World investment report

\textsuperscript{749} Stephen D. Cohen(2006), Multinational Corporations and Foreign Direct Investment, Oxford University Press.; PP11-15
Chapter 8
Conclusions and Implications

FDI has played a pivotal role in economic growth and is often referred to as the engine of growth. MNCs have influences on both political and economic agenda of the host country, as well as being a fundamental driver of economic development. This research investigated to what extent Oman has been successful in attracting and utilising FDI. It also explained the central importance of FDI productivity spillovers and the great potential to support and enhance the Omani economy, particularly in the domestic private sector, and subsequently add value to long-term development.

This concluding chapter summarises the research findings that have been drawn from the primary and secondary data. It is divided into five sections. In the first section, it presents the key findings and how they address the research questions. The second section focuses on the implications of the findings for policymakers, and domestic and foreign investors. The third section presents the contribution made to theory and knowledge, as well as practice. The fourth accounts for the limitations of the research. Finally, the fifth section provides suggestions for further research.

8.1 Key Findings

This study aims to assess Oman’s success in using FDI as the instrument for enhancing the productivity of manufacturing firms. It finds that Oman has experienced some positive effects of spillover from FDI, but overall the amount and impact of FDI spillover has been limited. The limited degree of success in using FDI as a tool to enhance productivity spillovers of manufacturing firms is due to two major overall structural problems. These can be classified into factors relating to the government and the factors relating to the private sector itself. These problems reveal that the conventional FDI theories have limited generalizability to Oman. Therefore, the government and business analysts

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should not rely on the conventional theories alone to understand and assess the productivity spillovers from FDI to domestic firms.

Many countries have developed economically and politically as a result of utilizing oil wealth. For example, Norway came top of the United Nations Development program list for using the benefits of North Sea petroleum in its social development. However, other similarly resource-rich states such as Oman have been less successful. These rentier states are led by elites that lack the ability to make the similar sweeping changes using oil revenue, fearing it would undermine their power. The concept of rentierism highlights how rents accumulated from outside the country would be generated by only a small fraction of the entire society, and that the state is the main first-line recipient of the wealth which is thereby generated. It is expected that this wealth is to be widely redistributed among the citizens.

The adverse political implications to the rentier economic model are that states are under no obligation to allow for political freedom because they do not ultimately rely for survival on domestic taxation. Hence, they can more easily limit independent political activity that may affect social stability. Fareed Zakaria explains that this is a source for the lack of political development because, in the absence of taxes, citizens have less incentive to place pressure on the government to become responsive to their needs. Instead, the government essentially 'bribes' the citizenry with extensive social welfare programs, becoming an allocation or distributive state. The budget, in effect, is little more than an expenditure programme.

In terms of economic factors it is evident that Oman is in the process of a strong economic development. GDP growth is well above the global average; it is classed as a high-income nation and has reached the level of a transitional economy. All of these factors are positive indicators that FDI within Oman would have a high chance of success. In particular, the factor of natural resource reserves creates a sterling opportunity for oil and gas opportunities to

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751 Mahdavy's(1970), Beblawi and Luciani(1990)
move into an industry that is far less saturated than many of its rivals. Furthermore, the Omani oil industry has using cutting-edge EOR technology that presents an exciting opportunity for oil and gas companies that are adapting to the use of these technologies.

However, Oman does have some aspects which for some industries may make Oman a far less attractive investment opportunity. The Oman market is less likely to be profitable for consumer goods companies, as the domestic market is small and intra-Arab trade is so low that it is not a worthwhile location for FDI. In addition, there is a substantial risk level for high-tech industries as levels of high-tech exports from Oman are extremely low. Furthermore, there is a substantial risk in the future of Oman’s business environment as the general stability could be altered with a change of leadership. Sultan Qaboos has been instrumental in building an Oman that some foreign businesses have found attractive, but the uncertainty of succession makes investment appear risky to foreign firms.

This political dynamic and the oil rent itself has had a strongly negative impact on the country’s private sector. As a result of this expenditure programme, Oman suffers from an overly dominant public sector, and a weak and somewhat ineffective private sector. As the public sector continued to enjoy better salaries, working environment, hours, and several other benefits, the private sector became weak internally as many employees migrated to work in the public sector enjoying better salaries and benefits along with their peers. This resulted in the private sector losing much of its most capable workforce. An additional negative consequence of the rentier model in Oman is that the increase in revenues from oil exports made Oman’s currency stronger compared to that of other nations. This resulted in Oman’s other exports being more expensive for other countries to buy while imported goods in Oman became cheaper and cheaper.

These difficulties in the governmental and private sector limited not just the abilities of local companies, but also the multinationals in several ways, considering that productivity spillovers do not just happen automatically, but need to be worked out.
In order to specifically account for why FDI has not served Oman’s economic development until now, this thesis highlights four pre-requisite elements which are considered necessary for productivity spillovers to accrue, and for domestic firms to be able to benefit from FDI. These elements include channels and mechanisms, as well as pre-condition factors and policies that are required to be in place. First, there is insufficient labour mobility, as the national capable workforce are resistant to working for domestic firms. In fact, the presence of MNCs has had a negative impact on domestic firms by increasing the wages which incentivises the national workers to leave domestic companies to work with MNCs for better wages and higher status. Second, domestic firms in Oman are not observing and learning from MNCs. This is because the demonstration effects channel lacks resources to operate properly, minimizing the benefit of spillover knowledge and expertise. Third, there is a weak business linkage channel. This is due to a passive government role in putting proper policies in place to create a viable environment for MNCs to operate in while also promoting creativity, not competition, between MNCs and domestic firms. Fourth, this study indicates that there were both positive and negative effects in relation to MNCs’ competition with domestic firms.

The second element of evidence is the key factors required for productivity enhancements, mainly of absorptive capacity in the domestic firms and at country level, including institutional framework, technology gap, and the lack of trained or qualified labour force. The third element is the lack of effectiveness of policies and platforms which are already in place. Even though there are some good policies in place (such as LCR, state-owned enterprises, investment maps, clusters and free zones) their impact is somewhat limited because they apply to specific sectors and are small in scale. Furthermore, these policies are managed by government technocrats working in an isolated manner and overloaded with other tasks, distracting them from achieving their expected performance. Fourth, the nature of FDI – Oman attracts a very small volume of

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753 Government spending packages crowd out the private sector, resulting in high dependence for employment of nationals on the government. Nationals expect to get a job in the government sector sooner or later thereby demonstrating lack of interest in their current private sector jobs. Private sector enterprises favour hiring expatriates who accept lower wages, require less training and are subject to more flexible labour market regulations compared to the local workforce.
FDI in comparison to its expected potential in non-oil-and-gas sectors. Most of the MNCs focus on Oman’s Oil and Gas sector. Therefore, the spillover is limited to this sector only, minimizing the benefit to domestic firms more generally. It is also noteworthy that Oman attracts FDI from few countries which limits the diversity of the technology, experiences, know-how and other features that domestic firms can benefit from.

The challenge for Oman is to figure out how to increase the impact of FDI productivity spillover in upgrading domestic businesses to help transform the country to private sector-led growth. It is essential to have sound political and economic (a business-friendly) environment but not over-friendly as incentive packages must be linked with development objectives such as productivity spillovers, export requirements, local input and national human resource development (see Figure 8.1). In addition, it is important that attention is paid to minimizing the costs associated with FDI to the host economy in terms of pollution, low health and safety standards, subcontractor abuse and making sure that there is respect for the natural environment. In order to achieve that, Oman needs to design and implement a new policy agenda to facilitate spillovers, including smart laws, procedures and programmes that have demonstrated their efficiency in a country with similar challenges. Sharing solutions could considerably accelerate the pace of spillovers and reduce government investment costs in spillovers.

Although differences among countries are many, similarities do exist with practical lessons that can be learned by optimizing best practice from leading countries. This study recommends some policies which need to be implemented simultaneously, along with many other well considered policies that Oman needs.

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754 Despite all efforts, Oman still does not manage to attract more than 0.02% of FDI worldwide and majority of inward FDI to Oman is resource-seeking FDI.

755 According to Centre of Information in 2011, 80% of FDI inflow came from 11 countries
This thesis has developed a strategic framework for an International Joint-Venture Business model (IJVB) that can help Oman and other countries with a similar structure to enhance productivity spillovers and develop domestic businesses. With this approach, the government must lead with interest and will, as in the case of most developing countries that continue to attract FDI successfully while also managing it properly such as to benefit the domestic businesses. By targeting key strategic sectors with high-growth potential, for example, manufacturing, tourism, fisheries and logistics, Oman as a whole can greatly develop its private sector.

An active role is needed for state-owned enterprises, as in the case of the Asian Tigers, among many other successful examples in developing countries. There exists a real need to improve current governance practice in relation to SOEs and to provide much needed support to develop domestic firms which lack resources and capabilities by assisting them to catch-up. The fragmentation of institutions that deal with FDI and domestic businesses hinders rather than helps the spillover objectives. A single institution is much needed to focus on and coordinate among all concerned stakeholders by delegating in the
form of departments to fully utilize and realize the benefits of productivity spillovers. There is also need for a detailed investment map for investment that includes all projects needed for the country’s development. The FDI firms seeking profit by utilization of host country’s market imperfection are not the least bit interested in developing the country as the core of their business relies on the imperfection – not the perfection. Finally, the SWOT analysis which was presented in this study can be used to build strategies for future FDI policies by considering how weaknesses can be turned into strengths, and how threats can be turned into opportunities.

It appeared from the analysis that there is a dilemma in relation to three factors repeated in all three elements of the analysis. These are government, human resources and private sector. Government showed as a source of strength and opportunity, as it has invested heavily in specific parts of infrastructure in the form of roads, ports, utilities, and other infrastructure, as well as having a diversification strategy, and creating several institutions and initiatives such as SOEs, free zones and clusters. Also, a liberal regime is supported by signature of a number of bilateral and multilateral international agreements, and working toward improving Oman’s business environment rating from international organizations. However, government also appeared as a source of weakness and threats due to slow decision making, efforts being scattered and not linked, failure in utilising and benefiting from what has been done and ineffective utilization of resources. For example, there has been inadequate spending on education and lack of training and proper preparation for its administrative team to manage those free zones and ports. There has also been a failure to market the country to attract sizable volume of FDI from diverse countries of origin.

With regard to human resources, 60% of the population are under 24 years, which gives potential fuel for business opportunities. However they are less motivated to work in private companies compared with the public sector, where they get better benefits. They also lack the expertise and skills needed for business, and tend to have an irresponsible work ethic.

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756 Oman must seek to build development institutions which encourage investment, growth and productivity – not predatory extractive institutions that favour the few.
The private sector offers strength and opportunity for economic growth. In this sector, there is less competition and government support in the form of funding and subsidy input. There is less local demand for both goods and services, as the country relies heavily on imports. On the other hand, this sector is fragmented in small units so that it is not able to compete internationally and has only weak capacity to accelerate learning from existing FDI firms and attract more. Above all, Oman must have administrative capabilities to successfully implement effective policies to attract FDI and enhance productivity spillovers.

8.2 Research Implications

There are three categories of implications from this research. First, the implications for policymaking concern government officials, as well as domestic and foreign investors. Second, there are implications for theory and knowledge. Third, there are implications regarding the development of a strategic framework business model for realization of productivity spillovers from MNCs to domestic firms.

1.2.1 Implications for policy-making

It is important to note that having FDI from diverse countries of origin contributes strongly to productivity spillovers. Policymakers should therefore seek to diversify where their FDI comes from in order to benefit from the unique technology and features offered by firms from each country. For example, firms from Japan are renowned for total quality management and low cost input, while firms from Germany are known for the high standard of their engineering. So, having a diverse range of investing countries will facilitate diversity of experiences and domestic firms can absorb a variety of technology and advantages to develop new products. In such products, each component is not necessarily new but the combination may be new.

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757 In Oman, more than two-thirds (67%) of investments were from just three countries: the UK, the USA and the UAE. 85% of all FDI stock in Oman in 2011 emanated from 9 countries

If Oman is to become a global business hub for companies from a variety of countries, the government must remove barriers for overseas investors to create a competitive business environment. This requires focusing on developing international standards of transparency. It also requires reducing the level of economic uncertainty, as the government's budget resources are derived mostly from oil exports and thus regularly miscalculated due to the usual gap between estimated and actual oil prices.\(^{759}\) This kind of uncertainty in the government's budget is an impediment to FDI because this makes it much more difficult for FDI to focus on medium to long term goals.

Furthermore, policymakers should look to attract FDI from countries which promote productivity spillovers and which have fewer restrictions in linkages with domestic firms.\(^{760}\)

Oman should encourage big MNCs already operating in Oman (such as OXY and BP) to establish a business support centre with the aim of assisting local businesses and focus on helping domestic firms win business with investing companies.

With regard to policies which would enhance productivity spillovers, this research shows the importance of the active role of government and the central importance of a high degree of coordination among all stakeholders in designing policies that can enhance productivity spillovers, and which produce agreement on the implementation practice and monitoring process. This is because of the nature of complexity of the business activities of MNCs and the need to remain competitive in a highly dynamic global economy. In this regard, this research provides a range of policies which would encourage productivity spillovers using a combination of initiatives and programmes, such as domestic content requirements, ownership structure, Free Zones, business linkages and export performance requirements.

\(^{759}\) Although fiscal institutions in Oman have developed considerably to become more transparent and inclusive. However, there remains concern that fiscal spending remains considerably pro-cyclical with oil prices. This is exacerbated with recent increase in social spending.

\(^{760}\) FDI from the USA meets these criteria. Javorcik and Spatareanu (2010), found positive spillovers from American MNCs.
The success of these and many other initiatives and aspects of the policy rely on three important elements. Firstly, the policy must be applied on a broad scale which could cause the desired effect on the economy. Secondly, the policy should be managed by a dedicated team who has a deep understanding of the rationale for implementing such initiatives and it is imperative to create a legal framework and clear policies which facilitate these initiatives. Thirdly, it is important that attention to be given to the implementation stage.

This study showed that Oman has a shortage of absorptive capacity, particularly in terms of the necessary institutions to drive private sector-led growth in terms of quality as well as quantity. Technical and managerial skills are also needed to drive these transformations. The quality of current institutions should be enhanced and new institutions created to build linkages and scale up success stories, e.g. SMEs support and education and training.

In term of the business environment, policymakers should ensure that Oman secures an advanced rating from international rating agencies to attract more FDI and so enhance efficiency, competitiveness and productivity. This can be achieved through a higher degree of coordination and cooperation between government and private sectors. In addition, it is vital that the Omani government provides better official statistics to these agencies so that they do not have to rely on secondary sources. This inconsistency of information may negatively affect country ranking in terms of the soundness of the business environment. Intensive media campaigns should be launched with all the necessary legal and political guarantees for enhancement of FDI productivity spillover to domestic enterprises.

Finally, it is important to recognise that good MNCs are hard to attract but once a country succeeds in bringing them in they tend to keep reinvesting in their operation. From this, they will have a continued economic positive impact on other domestic companies and the supply chain.

The implication for domestic business is that it is the domestic firms’ responsibility to be better organized, more inclusive, more creative and more dynamic, in order to be a credible partner of government and MNCs. For this,
they must improve their absorptive capacity to learn. The bigger and stronger they are, the more they can learn and gain productivity spillovers from MNCs.\textsuperscript{761}

Regarding the implications for FDI companies, they must not look at how they can prevent knowledge from being transferred to local enterprise. Instead, they must look at opportunities to learn from domestic firms. For example, the Omani oil industry is using cutting edge EOR technology that presents an exciting opportunity for oil and gas companies that are adapting to the use of these technologies. MNCs should have designated talent scouts to spot local suppliers or vendor development programmes to promote linkages between MNCs and domestic firms.

1.2.2 Implication and contribution to theory and knowledge

The theoretical suggestion that the presence of FDI has a positive effect on the productivity of domestic firms has been confirmed in empirical evidence for developed countries (e.g. Kinoshita & Chia-Hui 2006). However, the evidence for the impact of FDI on the domestic firms of developing countries, through productivity spillovers, is mixed (Navaretti & Venables, 2004; Gorg & Greenaway, 2004). This indicates a need for further research.

The body of theoretical research in the area of using FDI to enhance private sector development thus far focuses on industrial countries, including Latin American, Asian, and other developing countries. But very little attention is paid to rentier states. Moreover, there is surprisingly little empirical research on FDI interactions with the private sector. In this vein, this study helped to fill a gap in the global literature about productivity spillovers in a particular category of developing countries: oil producing countries which are characterized by the Dutch disease and a unique economic rentier structure. This thesis thus contributes to theory by studying FDI productivity spillovers in Omani manufacturing firms. To the best of my knowledge, this is the first study on FDI productivity spillover in Oman, and the findings may be generalizable to countries with similar economic structures, such as the Gulf region economies and other oil producers.

\textsuperscript{761}EOR technology is very attractive to MNCs, as it can be used in other oil producer countries when they reach Omani conditions
It is worth noting that productivity spillovers have been studied in a context where local human resources are not much engaged in domestic firms and domestic firms rely mainly on expatriates. Moreover, these firms are characterized by weak absorptive capacity and ability to learn and adopt new productivity features to local conditions.

This research conducted a deep investigation of the relationship between FDI and the local private sector. This makes a significant contribution to knowledge in better understanding how FDI can be used as a tool for supporting and enhancing the private sector in host economies as well as serving policymakers and decision-makers in forming more effective FDI policies. As national markets decline and of global markets rise, there is a need for change in the FDI policy agenda in oil producing economies. There is also a need for change in the strategy of industry so as to have a better understanding of the conditions which best facilitate transfer of knowledge from FDIs and links to the local economic context. Thus the limited literature addressing how policymakers and domestic businesses realize the potential benefits of FDI through productivity spillovers, and the major gap between existing theory and practice, make this an important area for research. This research makes a contribution to this major issue by providing new insights into the development of host economy competences (public and private) for realizing productivity spillovers from FDI.

This research extends existing research on FDI spillovers in various dimensions. For example, many existing studies have merely offered a partial description of productivity spillover effects by analysing only one of the effects or channels of spillovers. Such studies have treated the mechanism by which the productivity spillovers are transferred as a black box.\(^\text{762}\) To the contrary, this study offers a more complete picture of FDI spillovers by distinguishing these spillovers effects according to their channels (technology, management, marketing techniques, capital, best practice; and skill, competition), mechanism (business linkages, labour mobility, demonstration effects, and competition) and preconditional factors (absorptive capacity, intellectual property rights, ownership structure and MNC motives).

\(^{762}\) Görg and Strobel (2005), p.695
This research is unique in examining stakeholders’ views on a potentially vital element in FDI spillovers, including an Investment Map, and local content agenda which can help in monitoring FDI in reaching a win-win situation for both FDI investors and the host economy. This research argues that the size and the extent of spillover benefits depends largely upon the role of the host government in preparing the preconditional factors for productivity spillovers to occur and the enforcement of these policies. Moreover, the case of Oman demonstrates that the rentier state model places structural limitations upon this process.

1.2.3 Strategic framework business model for productivity spillovers realization

This research makes an important contribution in tackling the continued failure of oil producing economies to use FDI as a tool for the enhancement of the private sector, enabling it to be the engine of growth which is a major challenge for countries where the government is dominant. The research produces a practical business model that can be used by oil producing economies with similar economic structures to Oman. Such economies are characterized by two main challenges, each tending to block a major channel of productivity spillover. The first of these channels is the labour mobility channel: oil producing economies like Oman have a characteristic labour market structure whereby local firms are dominated by expatriates, who are typically employed on short-term contracts and so do not stay in the country for long. On the other hand, local human resources prefer to work in a public sector job and see the private sector as a transit. Therefore there is a tendency not to learn new knowledge and skills. The second channel is the demonstration effect where local firms can enhance their productivity through observation and imitation of MNCs economic activity. However, this effect tends to be limited because the majority of local firms are small and they do not typically have the threshold or minimum requirement to learn effectively from MNCs.

To overcome these two important challenges which tend to prevent productivity spillovers from FDI to local firms, this research proposes a model which involves the creation of an international joint venture where government
plays a major role in all five stages of the spillover process. This business model can offer substantial mutually beneficial opportunities to the government, the private sector and the FDI investor. By utilizing the model, government can develop a stronger private sector, stimulating an entrepreneurial spirit for SMEs and job opportunities for locals. Also, for domestic companies including SMEs, this model can be one of the fastest and most effective ways of upgrading the domestic private sector, through traditional spillover benefits such as transfer of technology, skill, management practices and others. Furthermore, this model provides a golden opportunity for FDI investors to strengthen their partnership with government, reduce costs, and enhance access to local assets and local market demand.

The International Joint Venture Business model

The ultimate objective for any given economy is to achieve sustainable development, based on economic diversification and growth. One way to achieve this is by diversifying economic outputs and in developed and industrialized countries this is mainly done through exploring different market and different needs. In developing countries, the more usual approach is diversifying the economic inputs through diversifying the income sources. Since this research focuses on developing countries, particularly Oman, diversification of income sources is the focus. As illustrated in figure (8.2), diversifying the economic income is achieved through improving the performance and competitiveness of the private sector.
There are three complexities that prevent a smooth transition for the Omani economy and inhibit the enhancement of productivity spillovers between FDI and domestic firms. First, in a rentier state, government plays a dominant role in the economy, and is the source of job creation, income, investment and services. Because the government receives a huge income from oil, this gives no incentive to the government to focus on developing other sectors including the private sector. This situation encourages local human resources to prefer to work in the public sector because of salaries and status. Second, the private sector is scattered in small units and its performance relies heavily on government spending and privileges such as subsidised inputs (energy and utilities). These factors are manifested in an inability to compete in international markets. Third, MNCs seek profit through utilization of opportunity and market imperfection in the host economy. They are very focused on their core business and tend not to have the motivation to spend resources (e.g. time or money) in identifying what is best for the long term growth and prosperity of the host economy.
1.2.3.1 Description of the Model

The International Joint Venture (IJV) business model (see Figure 8.3) recommends a new approach that may help to deal with these current complexities. The new holistic approach focuses on building a partnership between Government (public sector), domestic business (private sector) and FDI (external sector). This approach must be driven by the government because of their dominant role and the availability of resources and must ensure a win-win arrangement for the partnership. The model has five sequential steps:

- **Step One:** Identify priority sectors for goods, services and business activity where Oman has comparative advantages (e.g. manufacturing, tourism, fisheries, food security) or identifying goods and services which are currently imported but could be produced locally with the help of FDI;

- **Step Two:** Identify potential FDI investors, targeting companies within sector and activities (goods and services) identified in Step One;

- **Step Three:** Identify the appropriate promotion and marketing plans including incentive packages needed to facilitate and enhance the attraction of the FDI firms identified in Step Two;

- **Step Four:** Work with the private sector to identify appropriative large firms that could suit the activity or goods and services identified in Step Two. At the same time, qualify and prepare the right SMEs to be ready to work with both large local firms and FDI firms;

- **Step Five:** Form the IJV business model. Ideally this would be composed of the following proportions of ownership: FDI firms 40%, local large firms 20%; four SMEs 20% and government firms 20%. The government would then work very closely with all stakeholders to execute the projects.
There are several challenges that need to be overcome in order for this model to be successful. They include the following:

- Securing internal commitment domestically within large firms, the four SMEs and the public companies;

- Having dedicated staff or departments look inclusively;

- Effective collaboration and communication between the private and public sectors; for this, special attention is required for business process management activities which can be grouped into categories such as design, modelling, execution, monitoring, and optimization.\textsuperscript{763}

- Implementation is the biggest challenge. A repetitive cycle of implementation, analysis and adjustment is required. The process of implementation, measuring, and making adjustments should continue to be a collaborative process among the stakeholders.

### 8.3 Limitations of the Research

- Because government acts as the engine of growth and influences all economic activities, the private sector tends to be less organized and

\textsuperscript{763} This is a bottleneck to identify potential opportunities for cost savings or other improvements.
studies are not available and not sufficient to make deeper analyses. This private sector faces structural weaknesses and there are numerous reasons for this. Some of the many reasons include fragmentation of the private sector in small enterprises, the high cost of borrowing, and the lack of ability of entrepreneurs.

- In assessing the business environment, the disagreement between the secondary data (which tends to define the business environment as poor) with the primary data (which tends to give a positive view of the Omani business environment) may be partly explained by the fact that the sample which provided the primary data is unrepresentative in terms of opinions on the business environment. In simple terms, those who are very unhappy with the business environment, or who have not even considered doing business in Oman, are not to be found in Oman. So one consequence of this is that bias is created towards those with reasonably favourable attitudes to Oman’s business environment. Additionally, there may have been a reluctance amongst the participants in the primary research to be too critical because they might have feared damaging relations with the Omani government. Furthermore, the secondary data is looking at trends over longer time periods than most research participants could meaningfully talk about. In any case, research participants were not necessarily in a position to know the ‘big picture’ since the participants could talk mainly from their own experience, but in most cases, did not have the facts and figures which are available to economists or government statisticians.

- The literature from Oman’s perspective on both FDI and micro level is limited at best, and unavailable in many cases. This limits the extent of historical analysis that is available to researchers.

- It is absolutely crucial to have accurate, timely and reliable statistics for better analysis. For this research, data was only available between 2002 and 2011; however a longer timeline of data is required to have better understanding of trend shifts and the relations of FDI and the private sector. This problem is not just limited to Oman, but the majority of developing countries alike.

- Regarding methodology, it was not possible to use probabilistic (random) sampling of key stakeholders as no sampling frame existed from which to
draw a sample, and it would not have been possible to construct one. The research wished to interview or survey those with experience of FDI in Oman and so purposive sampling was used, in particular snowball sampling. In this approach, participants who met the criteria were invited to identify other possible participants who fit the criteria. While this sampling strategy was effective in recruiting participation from those people with the best knowledge of FDI in Oman, it has the disadvantage that one cannot necessarily generalise from the sample to the population from which it is drawn and therefore there is some degree of doubt about how representative the research participants are. Amongst foreign investors, the sampling was limited to companies operational in Oman and therefore there is a risk that the views of MNCs that are unhappy with the business climate in Oman (because they have already left) are not captured. The findings may represent an overly positive view of MNCs’ perceptions of the business environment in Oman. In addition, in the absence of anonymity, respondents may have been reluctant to make any critical remarks about the Omani government or associated institutions for fear of damaging their business relationship.

8.4 Suggestion for Future Research

- Further research is needed to assess the incentive packages Oman offers to FDI investors and how these can be linked with achievement of development objectives. This is because of the limited productivity spillovers from FDI to domestic firms, and the little contribution of FDI on two main policy objectives, that of economic diversification and employment.\textsuperscript{764}

- Little research is being done on the investment map and in-country requirement programme. More is needed.

- The private sector role in growth and the labour market dilemma in Oman\textsuperscript{765} needs deep study because there are a multiple social, culture and political and economic factors associated with it.

\textsuperscript{764} Many countries offer foreign investors more favourable treatment than they give domestic producers. Are such policies justified?

\textsuperscript{765} The labour market challenge has two dimensions. First, it is a young and rapidly growing national labour force; and it heavy relies upon expatriate labour in the private sector. Second,
• This study covered ten years (2002 to 2011). Therefore, future studies are needed when new data becomes available so that the impact of FDI productivity spillovers can be assessed periodically and policies can be improved accordingly.
• Since this study was concerned mainly with the manufacturing sector, an intensive study should be conducted of other business sectors such as minerals and tourism where Oman has comparative advantages.
• More studies are needed to compare the Omani business environment with that of other countries, particularly those which have characteristics similar to the Omani economy.
• The strategic business model framework proposed in this thesis for realizing productivity spillovers needs more research and testing.
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### Appendix (1): National Characteristics of the Development Plans

<table>
<thead>
<tr>
<th>Plan and Period</th>
<th>Characteristics</th>
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<tbody>
<tr>
<td>From 1971-1975</td>
<td>Dedicated to the preparation of the basis of a modern, stable and unified state.</td>
</tr>
<tr>
<td>The first plan 1976-80</td>
<td>Witnessed the first five-year plan followed by seven five-year plans. First plan characterized by high investment in highly needed infrastructure.</td>
</tr>
<tr>
<td>The second plan 1981-85</td>
<td>Coincided with high oil prices, hence, positive state finances. Thus, the government initiated the State General Reserve Fund (SGRF) in 1980 as an inheritance for the future generations.</td>
</tr>
<tr>
<td>The third plan (1986-90)</td>
<td>Disturbed by the first oil prices downfall. Nevertheless, for political reasons the government continued its spending, particularly current expenditure, which burdened the government finance. To mitigate the impact, the government resorted to SGRF.</td>
</tr>
<tr>
<td>The fourth plan (1991-1995)</td>
<td>Focused efforts to direct investment towards expanding production projects to enhance diversification of the economy through increasing production base. The private sector was seen as the leader of such achievements. Thus, privatization law was enacted by Royal Decree no.32/96.</td>
</tr>
<tr>
<td>The fifth plan (1996-2000)</td>
<td>Sought to balance state budget and continue implementing the objectives of the previous plan. The increase in oil prices resulted in a huge increase in oil revenues.</td>
</tr>
<tr>
<td>The sixth plan (2000-2005)</td>
<td>Aimed at achieving stability in the per capita income, sustainable fiscal policies, expanding the employment pool of the citizens, improving education, and enhancing diversification efforts. The oil price boom gave the plan a &quot;shot in the arm&quot; which in turn translated into positive contribution to government revenue, which compensated the decrease in oil production.</td>
</tr>
<tr>
<td>The seventh plan (2006-2010)</td>
<td>Non-oil activity showed great improvement. For example, the natural gas-based industries registered high growth</td>
</tr>
</tbody>
</table>
rates with an annual average of 32.8%. The tourism sector value added grew at an annual rate of 9.9% on average, which led to an increase in its annual average for the Plan period of 6.8% above the target. The private sector also contributed an average annual rate of about 8.2% to the increase in GDP.

| The eighth plan (2011-2015) | The main objectives are to realize a growth rate of not less than 3% and low inflation rates, observance to social area to be awarded priority in allocating government expenditure, expansion in provision of new work opportunities for Omanis, development of the sectors of tourism, industry, agriculture, fisheries and water resources and stimulating domestic and foreign private sectors to investment and development of small and medium establishments (SME). |
## Appendix (2): Investment Environment in Oman: Observations of International Agencies

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<th>Current Assessment</th>
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<td>Human Development Report</td>
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<td>56</td>
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<td>Doing Business report issued by the IFC and the World Bank</td>
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<td>World Competitiveness Report issued by the International Institute for Management Development (IMD), Switzerland</td>
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<td>World Economic Freedom Report issued by the</td>
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<td>Fraser Institute in Canada</td>
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<tr>
<td>Economic Freedom Report issued by the Foundation</td>
<td>2011</td>
<td>48</td>
<td>2014</td>
<td>56</td>
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<td>Heritage Foundation and Wall Street Journal</td>
<td>2010</td>
<td>43</td>
<td>2015</td>
<td>178</td>
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<td>Transparency International report issued by</td>
<td>2009</td>
<td>39</td>
<td>2013</td>
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<td>Transparency International</td>
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<td>The Global Information Technology Report by the</td>
<td>2011</td>
<td>41</td>
<td>2013</td>
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<td>World Economic Forum</td>
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<td>State Index, the most stable of the U.S. Fund for</td>
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<td>146</td>
<td>2014</td>
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<td>Peace</td>
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<td>Global Peace Index, issued by the Institute of</td>
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<td>23</td>
<td>2014</td>
<td>59</td>
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<td>Economics and U.S. peace</td>
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Source: Compiled by author
Appendix (3): Supporting Letters from SCP and PEIE

Sultanate of Oman
Supreme Council for Planning
Secretary General’s Office
Muscat

REC Reference Number: REP-H/12/13-31

Date:

Dear:

After Compliments:

We would like to invite you to participate in this questionnaire “Examining the role of foreign direct investment in enhancing the efficiency of the private sector and its contribution to the economic development process in the case of Oman”. By Mr. Yousuf Hamad Al Bulushi, a staff in Supreme Council for Planning, currently studying for a PhD at King’s College, London, UK.

The research objectives are to examine the spillover effects of Multi-National Corporations on the domestic firms through different mechanisms and assess the effectiveness of policy instruments and platforms in the host economy in achieving the objectives mentioned above.

By completing this questionnaire you are assisting in strengthening the information used for efficient Foreign Direct Investment and Private Sector policies.

For further information, please contact the Researcher Mr. Yousuf Hamad Al Bulushi at 99313714 or Email: yousufhamad@yahoo.com

Hoping for your cooperation in the best of public interest

Sultan Salim Al-Habsi
Secretary General, Supreme Council For Planning
إلى من يهمه الأمر

نود إفادتهكم بأن الفاضل / يوسف بن حمد بن حمد البلوشي يصدد عمل دراسة حول "دور الاستثمار الأجنبي المباشر في تطوير القطاع الخاص والمساهمة في تحقيق التنمية الشاملة للاقتصاد العماني" للحصول على شهادة الدكتوراه.

عليه يرجى التكرم مساعدته لقابلة الفاضل / مدير عام المصنع / الشركة.

وقد أُعطيت هذه الشهادة له بناءًا على طلبه دون تحميل المنطقة أدنى مسئولية تجاه الغير.

وتفضلوا بقبول فائق الاحترام والتقدير.

فهد بن عبد الرحمن الخان
مدير دائرة الشؤون الإدارية
<table>
<thead>
<tr>
<th>Code</th>
<th>Designation</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>IO1</td>
<td>Executive Director</td>
<td>Official</td>
</tr>
<tr>
<td></td>
<td>Industrial Innovation Center</td>
<td></td>
</tr>
<tr>
<td>IJV2</td>
<td>Chief Financial Officer</td>
<td>Joint Venture</td>
</tr>
<tr>
<td></td>
<td>Oman International Container Terminal LLC</td>
<td></td>
</tr>
<tr>
<td>IO3</td>
<td>Director General</td>
<td>Official</td>
</tr>
<tr>
<td></td>
<td>Oman Chamber of Commerce &amp; Industry</td>
<td></td>
</tr>
<tr>
<td>ID4</td>
<td>In-Country Value Delivery Lead (FPI/2)</td>
<td>Domestic Company</td>
</tr>
<tr>
<td></td>
<td>Petroleum Development Oman LLC</td>
<td></td>
</tr>
<tr>
<td>IF5</td>
<td>Senior Vice President</td>
<td>Foreign Company</td>
</tr>
<tr>
<td></td>
<td>Shadeed Iron &amp; Steel LLC</td>
<td></td>
</tr>
<tr>
<td>IO6</td>
<td>DG of National Business Center</td>
<td>Official</td>
</tr>
<tr>
<td></td>
<td>Public Establishment For Industrial Estate</td>
<td></td>
</tr>
<tr>
<td>IO7</td>
<td>Director General, Investment Promotion</td>
<td>Official</td>
</tr>
<tr>
<td></td>
<td>Public Authority for investment Promotion &amp; Export Development</td>
<td></td>
</tr>
<tr>
<td>IJV8</td>
<td>Civil Engineer</td>
<td>Joint Venture</td>
</tr>
<tr>
<td></td>
<td>Strabag Oman LLC</td>
<td></td>
</tr>
<tr>
<td>ID9</td>
<td>Hotel Manager</td>
<td>Domestic Company</td>
</tr>
<tr>
<td></td>
<td>City Hotel – Duqm</td>
<td></td>
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<tr>
<td>IF10</td>
<td>General Manager</td>
<td>Foreign Company</td>
</tr>
<tr>
<td></td>
<td>Muna Noor Manufacturing &amp; Trading LLC</td>
<td></td>
</tr>
<tr>
<td>ID11</td>
<td>Director</td>
<td>Domestic Company</td>
</tr>
<tr>
<td></td>
<td>Poly Products L.L.C.</td>
<td></td>
</tr>
<tr>
<td>IF12</td>
<td>General Manager</td>
<td>Foreign Company</td>
</tr>
<tr>
<td></td>
<td>Crowne Plaza Duqm</td>
<td></td>
</tr>
<tr>
<td>IJV13</td>
<td>General Manager (Operations)</td>
<td>Joint Venture</td>
</tr>
<tr>
<td></td>
<td>Reem Batteries &amp; Power Appliances Co. SAOC</td>
<td></td>
</tr>
<tr>
<td>IJV14</td>
<td>Partner – General Manager</td>
<td>Joint Venture</td>
</tr>
<tr>
<td></td>
<td>Muscat Steel Industries Co. LLC</td>
<td></td>
</tr>
<tr>
<td>ID</td>
<td>Position</td>
<td>Company/Title</td>
</tr>
<tr>
<td>------</td>
<td>-----------------------------------------</td>
<td>---------------------------------------------------</td>
</tr>
<tr>
<td>IJV15</td>
<td>Head – Plant</td>
<td>Oman Pharmaceutical Products Co. L.L.C.</td>
</tr>
<tr>
<td>ID16</td>
<td>General Manager</td>
<td>Salalah Macaroni Co. S. A. O. C.</td>
</tr>
<tr>
<td>ID17</td>
<td>Group Head of Sales &amp; Logistics</td>
<td>Raysut Cement Company (S. A. O. G.)</td>
</tr>
<tr>
<td>IJV18</td>
<td>Resident Managing Partner</td>
<td>Trowers &amp; Hamlins</td>
</tr>
<tr>
<td>ID19</td>
<td>Managing Director</td>
<td>Bahwan Exel LLC</td>
</tr>
<tr>
<td>IO20</td>
<td>Assistant Director General</td>
<td>Public Establishment For Industrial Estates</td>
</tr>
<tr>
<td>IO21</td>
<td>Director General of Research &amp; E-Services</td>
<td>Public Authority for Investment Promotion &amp; Export Development</td>
</tr>
<tr>
<td>IO22</td>
<td>Director of Operations</td>
<td>Public Establishment For Industrial Estates</td>
</tr>
<tr>
<td>IO23</td>
<td>Director of Media &amp; Communication</td>
<td>Public Establishment for Industrial Estates</td>
</tr>
<tr>
<td>ID24</td>
<td>HCU Manager</td>
<td>TAKATUF</td>
</tr>
<tr>
<td>IO25</td>
<td>Director of Administrative Affairs</td>
<td>Public Establishment for Industrial Estates</td>
</tr>
<tr>
<td>IJV26</td>
<td>Snr Planner &amp; Economist</td>
<td>Daleel Petroleum LLC.</td>
</tr>
<tr>
<td>ID27</td>
<td>Managing Director</td>
<td>Oman Industry</td>
</tr>
<tr>
<td>IO28</td>
<td>Director</td>
<td>Ministry of Oil &amp; Gas</td>
</tr>
<tr>
<td>ID29</td>
<td>Chairman</td>
<td>Al Fairuz Group</td>
</tr>
<tr>
<td>Code</td>
<td>Name</td>
<td>Position</td>
</tr>
<tr>
<td>------</td>
<td>-------------------------------------------</td>
<td>----------------------------------------------------</td>
</tr>
<tr>
<td>IO30</td>
<td>Director General of Rusayl Industrial Estate</td>
<td>Official</td>
</tr>
<tr>
<td>IJV31</td>
<td>Head of In Country Value</td>
<td>Joint Venture</td>
</tr>
<tr>
<td>IF32</td>
<td>General Manager</td>
<td>Foreign Company</td>
</tr>
<tr>
<td>IO33</td>
<td>Director General</td>
<td>Official</td>
</tr>
<tr>
<td>IJV34</td>
<td>GM – Strategic Business Development</td>
<td>Joint Venture</td>
</tr>
<tr>
<td>ID35</td>
<td>Managing Director</td>
<td>Domestic Company</td>
</tr>
<tr>
<td>IF36</td>
<td>Managing Director</td>
<td>Foreign Company</td>
</tr>
<tr>
<td>IF37</td>
<td>Supply Chain Manager</td>
<td>Foreign Company</td>
</tr>
<tr>
<td>ID38</td>
<td>CEO</td>
<td>Domestic Company</td>
</tr>
<tr>
<td>ID39</td>
<td>CEO</td>
<td>Domestic Company</td>
</tr>
<tr>
<td>ID40</td>
<td>In-Country Value Manager</td>
<td>Domestic Company</td>
</tr>
<tr>
<td>ID41</td>
<td>Chief Financial Officer</td>
<td>Domestic Company</td>
</tr>
<tr>
<td>IO42</td>
<td>CEO Freezone Sohar (SFZ)</td>
<td>Official</td>
</tr>
<tr>
<td>IO43</td>
<td>Seniore Economist</td>
<td>Official</td>
</tr>
</tbody>
</table>
Appendix (5): The Questionnaire

University Of London

PhD Questionnaire

Middle East & Mediterranean Studies

Examining the role of foreign direct investment in enhancing the efficiency of the private sector and its contribution to the economic development process in the case of Oman
“Examining the role of foreign direct investment in enhancing the efficiency of the private sector and its contribution to the economic development process in the case of Oman”

I would like to invite you to participate in this postgraduate research project. Before you decide whether you want to take part, it is important to understand why the research is being done and what your participation will involve. Please take time to read the following information carefully and discuss it with others if you wish. Please ask me if there is anything that is not clear or if you would like more information.

This PhD research seeks not only to address major research issues that have been hitherto understudied, but also to be of significant benefit to Oman’s policymakers and local private sector. It can provide better understanding of the potential benefits of FDI spillover effects on local companies through transfer of know-how, technology and governance. The Supreme Council for Planning in the Sultanate of Oman provides full scholarship for this research. However, data and finding will be used only for the academic purposes related to this study at King’s College, London.

The research objectives are:

- To examine the spillover effects of FDI on the domestic firms through different mechanisms, including business linkages, labor mobility and demonstration effects, taking into consideration how the factors in the host economy may affect the size of the spillovers from FDI. These factors include absorptive capacity, intellectual property rights, ownership structure and Multi-National Corporations’ (MNCs) motives.
- To assess the effectiveness of policy instruments and platforms in the host economy in achieving the objectives mentioned above.
- To investigate whether there are benchmarks or best practices derived from experiences of other countries’ use of growth-driven FDI, that may facilitate the achievement of the above objectives.
To date, there has been no investigation in the case of Oman in terms of the above aims. Furthermore, a developing country like Oman is an exciting case because FDI has great potential to support and enhance the economy, particularly in the domestic private sector, and subsequently add value to long-term development.

Participating in this questionnaire will be considered as an effective input. However, deciding not to participate will not affect you in any negative way. If you decide to take part you are still free to withdraw any data/information you have already provided up until it is transcribed for use in the final report on 30th of December 2013.

I would be grateful if you could spare some time to complete the questionnaire. Answers and responses will be kept confidential and results will be used only for academic purposes with no specific individuals identified. I would like to assure you that this research complies with the UK Data Protection Act 1998 and the participants must be informed of what information will be held about them and who will have access to it. If this study has harmed you in any way, you can contact King's College London using the details below for further advice and information: Dr Ashraf Mishrif, telephone: +44 (0) 20 7848 1798, Email: ashraf.mishrif@kcl.ac.uk

I am happy to share all the findings of my thesis with you. If you decide so please contact the researcher. Your kind consideration and invaluable support regarding this matter is highly appreciated. I am enclosing a support letter from the Supreme Council for Planning as well as a reference letter from my university.

If you have any questions or require more information about this study, please contact the researcher using the following contact details: Yousuf bin Hamad Al Balushi, working with the Supreme Council for Planning, Oman and at present, Ph.D. candidate at King’s College, London. Email: yousuf.al_balushi@kcl.ac.uk

Submission of a completed questionnaire implies consent to participate.
CONSENT FORM FOR PARTICIPANTS

Please complete this form after you have read the Information Sheet and/or listened to an explanation about the research.

Title of Study: “Examining the role of foreign direct investment in enhancing the efficiency of the private sector and its contribution to the economic development process in the case of Oman”

King’s College Research Ethics Committee Ref: REP-H/12/13-31

Thank you for considering taking part in this research. The person organising the research must explain the project to you before you agree to take part. If you have any questions arising from the Information Sheet or explanation already given to you, please ask the researcher before you decide whether to join in. You will be given a copy of this Consent Form to keep and refer to at any time.

Please tick or Initial:

☐ I understand that if I decide at any time during the research that I no longer wish to participate in this project, I can notify the researchers involved and withdraw from it immediately without giving any reason. Furthermore, I understand that I will be able to withdraw my data up to the point of publication in 30 December 2013.

☐ I consent to the processing of my personal information for the purposes explained to me. I understand that such information will be handled in accordance with the terms of the UK Data Protection Act 1998.

☐ I agree that the researcher may use my data for future research and understand that any such use of identifiable data would be reviewed and approved by a research ethics committee.

☐ I consent to my interview being audio recorded.
Participant’s Statement:

I ______________________________ agree that the research project named above has been explained to me to my satisfaction and I agree to take part in the study. I have read both the notes written above and the Information Sheet about the project, and understand what the research study involves.

Signed: ______________________________       Date: _________

Investigator’s Statement:

I Yousuf Bin Hamad Al Balushi, confirm that I have carefully explained the nature, demands and any foreseeable risks (where applicable) of the proposed research to the participant.

Signed: ______________________________       Date: _________
Part A: General Information

Name of respondent (optional): 

Name of organization: 

Note: Please tick the appropriate response

Occupation:
- Technical
- Admin
- Senior Management

General economic activity:
- Primary
- Manufacturing
- Services

Main economic activity:
- Oil and Gas
- Manufacturing
- Tourism, Fishery, Metals, Logistic, Education
- Others

Location:
- Muscat
- Soher
- Salalah
- Duqm
- Other

Number of years in Oman:
- 0 to 5 years
- 5 to 10 years
- 10 to 15 years
- More than 15 years.

Ownership Structure:
- Resident of Oman Percentage: -----%
- Non-Resident of Oman Percentage: -----%

---

766 Include; Financial Intermediation, Utility, Construction, Trade, Real Estate and other
1. The following factors were considered for Foreign Direct Investment (FDI) in Oman:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securing raw-material supply</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilizing local location</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accessing cheap labour</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Following major clients (vertical network)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investing with other firms in same industry (horizontal network)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expanding markets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collecting market information</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capitalizing on tax incentives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acquiring key or new technologies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilizing quality infrastructures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Oman is a suitable place for Foreign Direct Investment

<table>
<thead>
<tr>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
</table>

3. The MNCs have any form of business arrangements with domestic enterprise? (i.e. suppliers, distributors, etc.)

<table>
<thead>
<tr>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
</table>

- 373 -
Part B: Spillover Channels and Mechanisms

I. Business Linkages

<table>
<thead>
<tr>
<th>4. MNCs assist domestic enterprises to improve their products or services</th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology, which leads to enhanced productivity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management, which leads to better control on time and quality</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketing techniques, which lead to increased exports</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital, which leads to more investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Best practices and skills which enhance labour productivity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The resulting competition improves efficiency in domestic market</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

The transfer of know-how, techniques, management style, experiences, way to do things from MNCs to local firms are commonly called “spillover”

MNCs can help the domestic enterprises through the backward and forward linkages they generate through market transactions. Linkages in our study context are defined as linking FDI companies not only with domestic ones but also with research institutes, academic and other institutes of mutual benefit. In this respect, two types of linkages exist: Backward linkages and Forward linkages

Technology that comprises the provision of modern machinery, equipment, and technical support to improve existing production-technology, adopt production processes and techniques, product planning and designs and technical specifications, a standard guideline to fulfill quality assurance requirements, technical consultations on product characteristics to your local suppliers in order to help them master new product-technology

e.g. inventory management and the use of various delivery and logistical systems

What effort has been made in order to force local firms to increase their managerial efforts, or to adopt some of the marketing techniques used by MNCs?
<table>
<thead>
<tr>
<th>5. There are linkages between MNCs and domestic enterprises</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect linkages with local competitor through demonstration effect and labour mobility.</td>
<td>Agree</td>
<td>Strongly</td>
<td>Agree</td>
<td>Neither</td>
</tr>
<tr>
<td>Direct forward linkages with local agents and/or customers for the marketing, distribution, or supply of inputs or other assistance for improvement.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct backward linkages with local suppliers and/or subcontractors for local sourcing, purchase of inputs or other assistance for improvement.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct linkages with local licensees and/or franchisees</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>6. MNCs do compete with domestic enterprises</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
</table>

772 Demonstration effect relies on real externalities, such as new technologies, new marketing techniques, and new types of products, when local firms learn through observation and imitate the multinational corporations incorporating them into local conditions.
II. Demonstration Effect

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

7. The domestic enterprises learn through observation and imitate the multinational corporations by adapting their new technologies, marketing techniques, and types of products according to the local conditions

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

8. There is effort being made by domestic enterprises in terms of demonstrating new technologies and training workers in order to master the new technology

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

III. Labor Mobility:

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

9. There are movements of workers from MNCs to domestically owned enterprises

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

10. There are movements of workers from domestic enterprises to MNCs

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

11. MNCs do assist the domestic enterprises in terms of types of training programmes offered by the organization in order to upgrade the human resource base of domestic suppliers

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12. MNCs do provide a type of in-plant training programme for managers and technicians working in the same enterprises

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strongly</td>
<td></td>
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13. Do MNCs provide a type of in-plant training programme developed for suppliers (domestic enterprises)
Part C: Preconditioned deterrent factors

| 14. Rate your level of satisfaction with quality of: (1: very low, 5: very high) |
|---------------------------------|---|---|---|---|---|
| Domestic Enterprises            |   |   |   |   |   |
| Local Human Resources           |   |   |   |   |   |
| Infrastructure                 |   |   |   |   |   |
| Institutions                   |   |   |   |   |   |

15. Which of the following factors do you think are key determinants of spillover from MNCs and that may influence linkage formation in Oman, with particular reference to absorptive capacity\textsuperscript{773}:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Agree</th>
<th>Agree</th>
<th>Neither</th>
<th>Disagree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Capital</td>
<td></td>
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<tr>
<td>Research and Development Capacity</td>
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<tr>
<td>Technology Gap</td>
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<tr>
<td>Intellectual Property Rights</td>
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<tr>
<td>Institutional Framework</td>
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</table>

16. What kind of Mode of Entry/Ownership of the Multinational Enterprise can influence linkage formation with domestic enterprises?

<table>
<thead>
<tr>
<th>Mode of Entry/Ownership</th>
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</thead>
<tbody>
<tr>
<td>International franchising</td>
<td></td>
</tr>
<tr>
<td>Branches</td>
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<tr>
<td>Contractual alliances</td>
<td></td>
</tr>
<tr>
<td>Equity joint ventures</td>
<td></td>
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<tr>
<td>Wholly foreign-owned subsidiaries</td>
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</tbody>
</table>

\textsuperscript{773} Can be defined as the capability of local firm to identify valuable new know-how, adopt it within its current technological development, and adjust it to suit its own specific uses, processes and routines.
Appendix (6): The Interview Questions

General:

1. How successful has Oman been in attracting FDI compared to other countries in the region, why?
2. What makes Oman an attractive destination for FDI?
3. Has Inward FDI contributed to the diversification objectives, developed export performance and generated employment opportunities for the local workforce? Why? Why not? Way forward
4. How can FDI be used as an avenue to support and enhance the efficiency of the private sector?
5. In what ways do activities of foreign affiliates in Oman contribute to the upgrading of domestic enterprises?
6. Are there any specific factors that are likely to bring about a greater degree of linkages between MNCs and domestic enterprises?
7. To what extent do you think the following policy guidelines are helpful in making Oman more attractive to foreign investment? (Not helpful/ Fairly helpful /Helpful)
   - Industrial free zones
   - Reducing capital required
   - Simplifying Administrative procedures
   - Allocation of land
   - Improving the infrastructure
   - Providing business maps
   - Improving human resources
8. How would you rate your level of satisfaction with the following services?
   - Banking
   - Insurance
   - Electric power
   - Water and sewage
   - Telecommunication
   - Postal service

774 Industry wise, source of revenues, geographical location
A) Spillover Channels and Mechanisms

(Explain how MNCs influence domestic enterprises upgrading)

I. Business Linkages

1. Are there any linkages between MNCs and domestic enterprises to improve their products or services in term of technology, management, marketing techniques, best practice and skill? Explain, How

2. Do MNCs enterprises compete with domestic enterprises? If yes, in what areas?

3. Are there specific factors that are likely to bring about a greater degree of linkage with the local economy than others?

II. Demonstration Effects

1. Is any effort being made by domestic enterprises in terms of demonstrating new technologies and training workers in order to master the new technology? What effort can be made?

I. Labour Mobility

1. Can you tell me about movements of workers between MNCs enterprises to domestically owned enterprises? From where to where? Why/Why not? Incentives for moving? What effect do the movements have for the enterprises?

2. Does the company assist the domestic enterprises in terms of types of training programmes offered by the organization in order to upgrade the human resource base of your suppliers?

D) Pre Conditional Deterrent Factors:

775 The transfers of knowledge, techniques, management style, experiences, way to do thing from MNCs to local firms are commonly called “spillovers”

776 MNCs can help the domestic enterprises through the backward and forward linkages they generate through market transactions. Linkages in our study context are defined as linking FDI companies not only with domestic ones but also with research institutes, academic and other institutes of mutual benefit. In this respect, two types of linkages exist: Backward linkages and Forward linkages

777 Demonstration effect relies on real externalities, such as new technologies, new marketing techniques, and new types of products, when local firms learn through observation and imitate the multinational corporations incorporating them into local conditions.
1. How would you rate your level of satisfaction with quality of the key determinants of spillover from MNCs that may influence linkage formation? With particular reference to Absorptive capacity\textsuperscript{778}
   A. Human Capital
   B. Research and Development capacity
   C. Technology Gap
   D. Intellectual Property Rights
   E. Institutional Framework
   (availability, price, quality, reliability, and technical complexity)

2. In terms of mode of entry or ownership structure of the Multinational Enterprise, do foreign investors who form joint ventures with domestic firms create greater benefits and influence linkage formation with domestic enterprises compared with fully foreign owned?

E) Public Policies/Strategies/Incentive\textsuperscript{779}

1. As spillovers from MNCs do not happen naturally, what kind of institutional conditions affecting successful spillovers and are there any public institutions in place in Oman that ensure and encourage spillovers between MNCs and domestic enterprises? 
2. Assess the effectiveness of policy instruments and platforms in Oman in achieving the spillover objectives.
3. Are there any other policies/strategies that can enhance spillovers from MNCs to domestic enterprises?
4. Do you think that preparation of the details linkages programme along with Investment Map would have a significant positive impact in attracting and monitoring FD? (Disagree, agree, nature, strongly agree)
5. What do you see as strengths and weaknesses of, and threats to and opportunities for the Oman business environment in relation to attracting FDI?

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
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</table>

\textsuperscript{778} Can be defined as the capability of local firm to identify valuable new knowledge, adopt it into its current technological development, and adjust it to its own specific uses, processes and routines.

\textsuperscript{779} Refers to a government’s plan or course of action intended to influence the operations of foreign entities (individuals, companies, institutions, etc.) investing in Oman
F) Benchmark or Best Practices:

Are there benchmark or best practices derived from experiences of other countries’ use of growth-driven FDI, which Oman can learn from first attracting FDI and second in enhancing spillover from MNCs to domestic enterprises?