REPORT

Leveraging FDI to Catalyze Economic Development

A blueprint for unlocking the potential of FDI

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Executive Summary

Amidst the backdrop of a rapidly evolving global economy, foreign direct investment (FDI) is emerging as an effective catalyst to spur economic development and growth. Governments are competing to attract investments, seeking not only the sizeable capital injections, but also the various accompanying benefits, including innovations, technology transfers, and knowledge spillovers.

The significance of attracting FDI is evident in governments' strides to incentivize and retain foreign investments. Governments are establishing long-term investment attraction strategies, introducing incentives, and setting up dedicated entities to oversee and ease FDI regulations to enable and facilitate foreign investments.

In this article, we highlight the role of FDI and its importance as a tool to develop a robust and resilient economy. Additionally, we examine three key components required to establish an enabling foundation to attract FDI and unlock its potential, including:

1. The criticality of establishing a strategic direction and vision
2. The importance of having investment enablers in place
3. The significance of adopting a whole-of-government approach and having comprehensive governance

1 Foreign Direct Investment Overview

FDI is considered an investment from a foreign economy (the "home" country) into a business or corporation in another economy (the "host" country) to establish a lasting interest[1]. FDI may take various forms, including the acquisition of voting stock in a foreign entity, mergers and acquisitions, joint ventures, and expansion into a foreign economy (greenfield or brownfield investments).

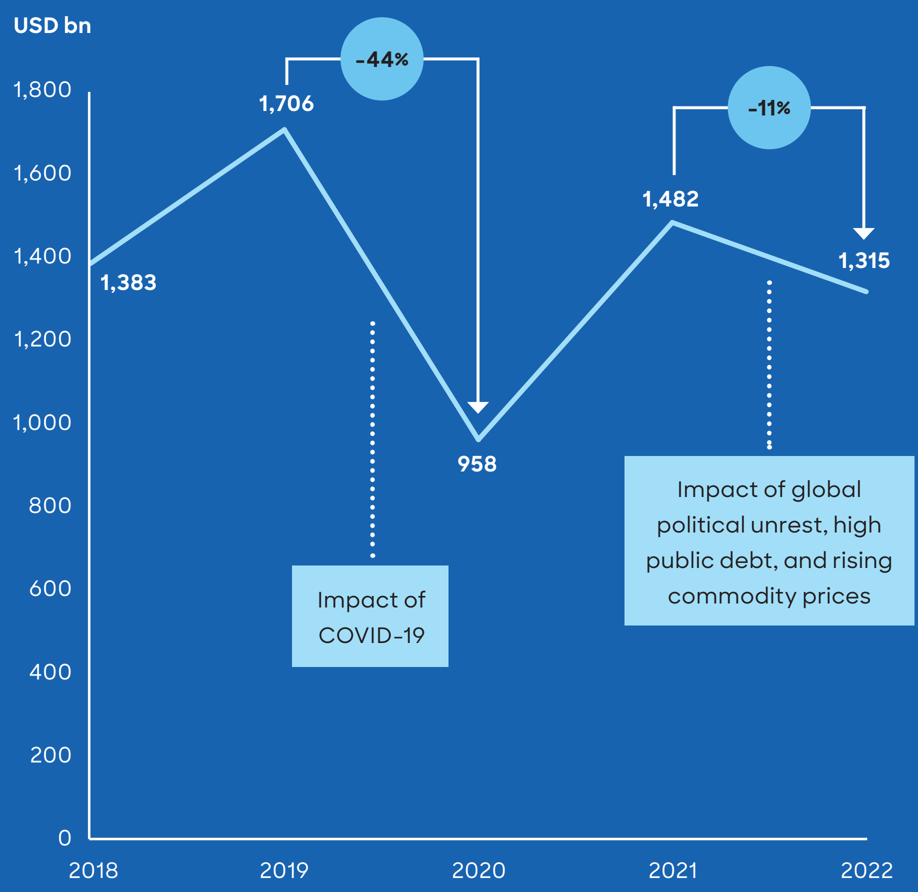
Various economic, social, and political factors influence FDI. Global FDI inflows have been fluctuating in recent years mainly due to the pandemic, political unrest, and rising commodity prices (figure A)[2]. The 46th issue of the UNCTAD Global Investment Trends Monitor Report estimates that 2023 FDI flows recovered and increased marginally by 3%. However, excluding European conduit economies, global FDI inflows declined by 18%, triggered by continued global economic concerns and geopolitical risks[3]. Governments continuously evolve investment policies to react to these external factors, and several countries are adopting measures to counter expected downturns.

1 Corporate Finance Institute

2 UNCTADstat FDI Inflows Database, accessed May 2024

3 UNCTAD Global Investment Trends Monitor, No. 46

A Global FDI inflows [USD billion], 5-year period (2018-2022)2



Source: UNCTADstat FDI Inflows Database, accessed May 2024

1 UNCTADstat FDI Inflows Database, accessed May 2024

2 UNCTAD Global Investment Trends Monitor, No. 46

3 UNCTAD World Investment Report 2023

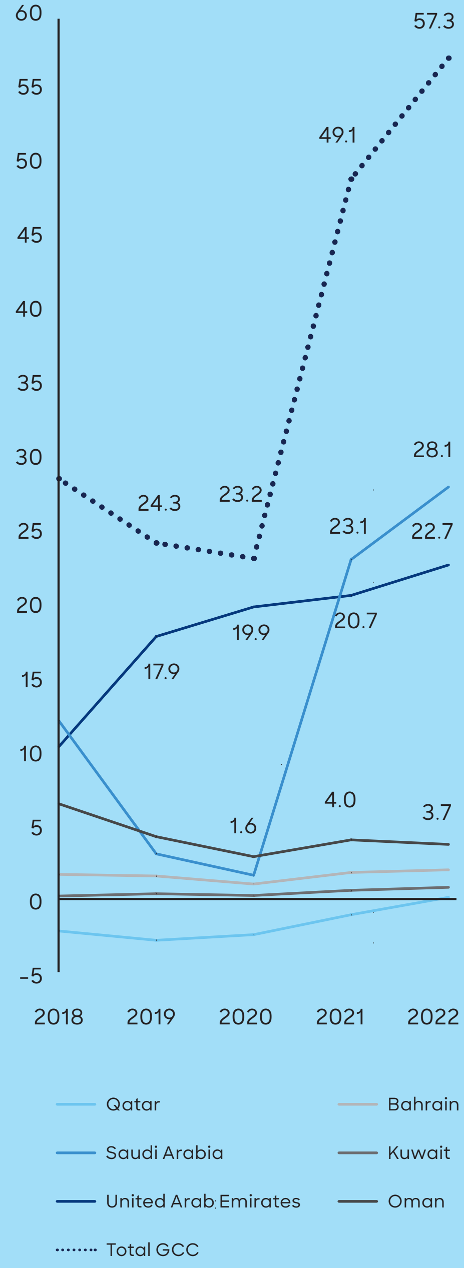
4 KSA National Investment Strategy

Global FDI activity identifies various trends and patterns. First, emerging markets like China, Brazil, and several Southeast Asian economies are becoming increasingly attractive for FDI due to rapid economic advancement (although there was a slight setback in 2023). Second, FDI activity is being channeled towards global value chain (GVC)-intensive sectors (e.g., automotive, machinery), as well as technology and innovation-driven sectors (e.g., IT and electronics). FDI is also being directed towards service-oriented sectors that complement manufacturing sectors. Lastly, governments are also attracting FDI towards sectors related to the United Nations Sustainable Development Goals (SDG), including infrastructure, renewable energy, water, sanitation, agrifood systems, and health and education[1,2,3]. These trends follow a push by countries to safeguard their economies and ensure sustainability. Whether these trends remain or change depends on macroeconomic factors and global dynamics.

Zooming in to Gulf Cooperation Council (GCC) countries (Figure B), FDI inflows grew at an 18.9% CAGR between 2018 and 2022, significantly higher than other growth hot spots such as Southeast Asia (10.6%)[1].

The Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE) are key GCC economies that attract and influence regional FDI inflows. As part of Vision 2030, the Saudi Arabian government is pushing to increase FDI, and it is aiming for USD 103 billion in annual FDI by 2030[4]. Between 2018 and 2022, KSA's FDI inflow grew 23.3%, the second highest among G20 countries after Japan[1]. Similarly, the UAE's FDI inflow grew at an impressive 21.6% CAGR from 2018 to 2022, reaching an all-time high of USD 22.7 billion, ranking the UAE as the 16th global destination for investment attraction[1].

B FDI inflows [USD billion] for GCC countries and total, 5-year period (2018-2022)



Source: UNCTADstat FDI Inflows Database, accessed May 2024

Overall growth in FDI inflows across the GCC can be attributed to legal reforms, the launch of strategic incentives, and infrastructure investments, among other focused efforts. For example, KSA has introduced the Foreign Investment Law to organize and attract FDI. The UAE has extended some of the benefits available to free zone companies to the broader economy and made it possible for investors of different nationalities to establish and own companies fully. Meanwhile, Qatar introduced a Public-Private-Partnership law to drive privatization and encourage investment.

FDI Significance and its Benefits

The correlation between FDI and economic growth has long been analyzed, with several papers suggesting a positive correlation, including the 2020 working paper by the European Investment Bank[5].

FDI drives economic growth and development by enabling host countries to avail themselves of direct and induced benefits. These are summarized in Figure C below and are the primary reason economies globally compete to attract foreign investments. Benefits such as capital injections, increased employment opportunities, and the transfer of technology and knowledge (direct benefits) are primary drivers for FDI. Meanwhile, other indirect benefits such as integration into global value chains, increased competitiveness, infrastructure development, and an improved balance of payments are further spill-over effects of FDI that economies want to have.

5 European Investment Bank, Gattini, L., Baiashvili, T., Impact of FDI on economic growth – The role of country income levels and institutional strength, European Investment Bank, 2020

C Direct and induced benefits from FDI

Direct Benefits

Capital injections: FDI provides the financial resources for governments to expand their respective countries' productive capacities.

Employment opportunities: Lower unemployment levels because of job opportunities generated by the establishment of new businesses or the expansion of existing businesses.

Technology transfers: Foreign entrants introduce new and innovative technologies and tools. These improve productive capacity, as well as raise the efficiency and competitiveness of firms in the host country.

Knowledge transfers: Foreign entrants often bring new skills and capabilities to host countries, leading to an increase in productivity.

Enhanced government-to-government (G2G) relations: Better relations between governments because of strategic partnerships and mutually beneficial cross-border investments.

Induced Benefits

Export stimulation: Investments can facilitate the formation of trade partnerships and lead to stronger export performance.

Strengthened local value chains: Local businesses in the host country may become part of the value chain of foreign entrants and access new opportunities.

Increased competitiveness: FDI raises the level of competition in the host country, requiring businesses to allocate resources more efficiently and to enhance their value proposition.

Infrastructure development: Underdeveloped regions may benefit from foreign entrants that invest in developing the local infrastructure.

Improved Balance of Payments: FDI contributes to higher records of capital inflows, as well as decreased imports and increased exports on the current account.

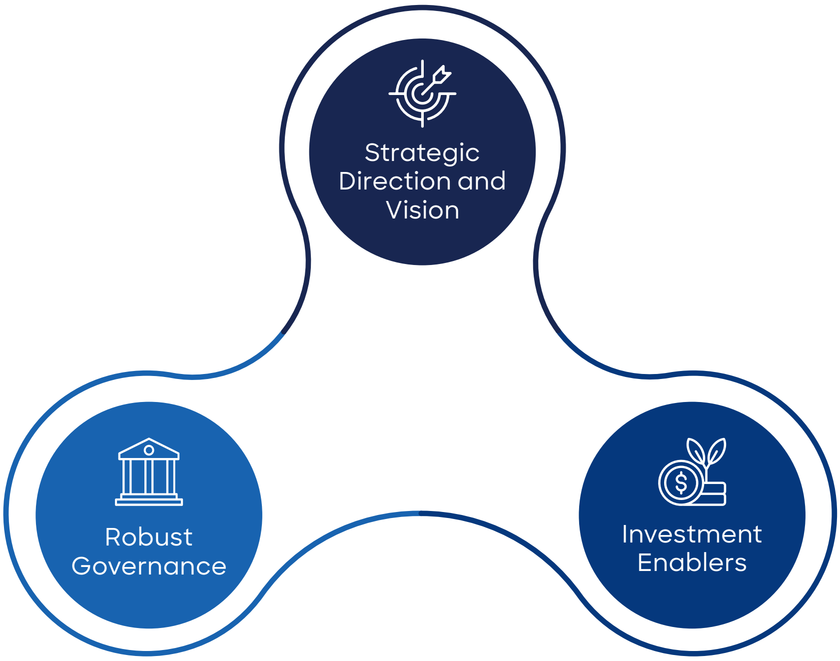
Source: Roland Berger

2

Key Elements for Successful FDI Attraction

Three key interconnected elements are critical to effectively attract and maintain FDI. These include a clear strategic direction, supporting investment enablers, and a governance structure that enables the strategy to be activated.

D Three key elements for successful FDI attraction



Source: Roland Berger

Strategic Direction and Vision

A dedicated FDI strategy with clear objectives constitutes the first step towards effective FDI attraction. Strategy setting begins with identifying the purpose of FDI attraction, including the benefits that the government wants to achieve (e.g., creating jobs or acquiring knowledge). When defining target benefits, it is important to understand that there are certain tradeoffs between benefits and that there is no one-size-fits-all for investments. For instance, healthcare research and development investments will likely result in substantial knowledge and technology transfers, whereas large-scale real estate investments might not provide similar benefits. This understanding will allow strategy setters to articulate more accurate investment strategies and objectives (the desired benefits), where to attract investment (target sectors and geographies), and who to attract investment from (home countries).

6 KSA National Investment Strategy (NIS)

7 UAE Ministry of Investment

For example, in 2021, Saudi Arabia issued the National Investment Strategy (NIS), which aims to grow investments in the Kingdom across prioritized sectors, setting an FDI target of USD 103 billion by 2030 (5.7% of GDP by 2030)[6]. As part of the strategy's priorities, KSA is focusing on growing the economic contribution of the private sector, supporting specific sectors' development (e.g., renewable energy, logistics, healthcare), and upgrading the investment ecosystem. Similarly, the UAE's recently established Ministry of Investment is developing a strategy to boost FDI to attract USD 150 billion in foreign investment by 2031[7] .

This trend of setting national strategies is expected to become more prevalent globally, with governments making coordinated and strategic efforts to attract FDI in order to achieve significant economic impact.

Investment Enablers

Beyond a clear strategy, governments should address two categories of factors that are typically considered by investors and therefore directly influence investment decisions. These categories can be classified as investment enablers, and they are an investment-enabling environment and investment-enabling mechanisms.

1. An investment-enabling environment considers key variables that directly impact the host country's economy, including political stability, regulatory quality, economic stability, market prospects, infrastructure development, labor availability and skills, property rights, and degree of innovation. Weaknesses across any of these areas will negatively impact investment attraction efforts, and therefore, governments need to ensure that these variables are well controlled. Recent global political unrest is a prime example, with various entities divesting or withdrawing investment plans in economies experiencing political unrest.

2. Investment-enabling mechanisms encompass levers governments deploy to support investors across various stages of the investment value chain. Governments may utilize monetary and non-monetary levers to entice and attract investors into their economies.

   - **Monetary levers:** Involves extending financial support to investors to facilitate investment. This could include, for example, tax incentives, financing feasibility studies, and providing subsidies.

   - **Non-monetary levers:** These include tools that governments use to create a favorable environment for investors. These levers address a wide range of topics, including supporting regulations (investment agreements and double tax agreements), setup support and information sharing, workforce development, and networking.

Figure E below provides an example of tools that may be applied along the investment value chain. All six GCC countries and a range of international countries currently deploy a combination of these mechanisms, with encouraging results.

E Overview of monetary and non-monetary levers across the investment value chain

Selection and non-comprehensive

Pre-investment	Investment	Operations	Post-investment
Issuing clear regulations and guidelines around FDI, intellectual property, profit repatriation, etc.	Extending grants, loans, subsidies, guarantees, or capital investments	Delivering business training	Extending financial incentives to encourage further investments and expansions
Financing feasibility studies	Providing legal and tax advisory support services	Promoting business matchmaking and investor networking	Establishing forums for public-private dialogue around FDI
Investor-friendly tax measures	Creating a one-stop-shop for administrative procedures	Delivering workforce development programs	
Signing investment agreements with foreign governments	Operational setup support (e.g., paperwork)	Offering facilities and support (e.g. workspaces)	
Publishing sector-specific market reports and relevant data on public platforms			

Monetary levers

Non-monetary levers

Source: Roland Berger

An investment-enabling environment and investment-enabling mechanisms work hand in hand. Efforts to introduce mechanisms in an economy with unsound economic conditions will have a limited effect. At the same time, governments that neglect the use of investment-enabling mechanisms in healthy economies miss opportunities to contribute to further economic development and growth.

Robust Governance

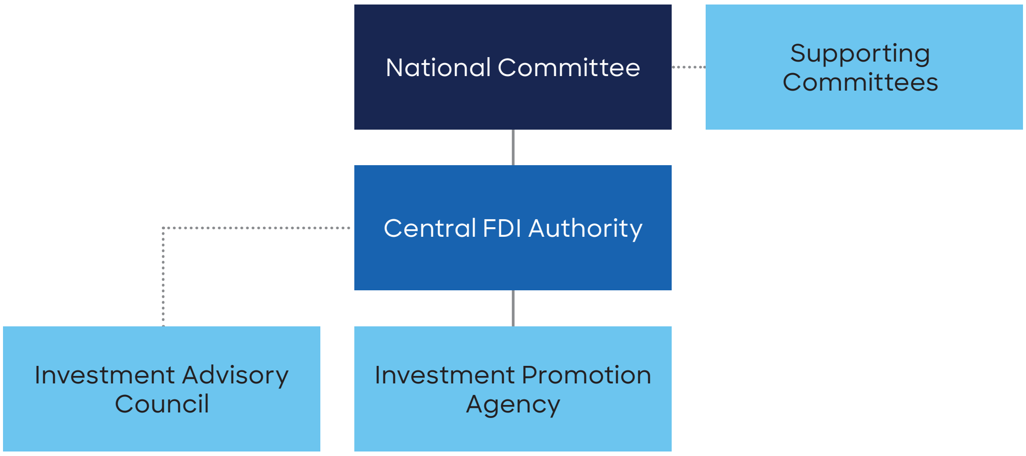
Launching a strategy with clear objectives and introducing investment enablers constitute the first two milestones towards compelling FDI attraction, but a strategy and enablers alone are insufficient. Strategy implementation and target achievement need to be driven and supported by adopting a whole-of-government approach and robust governance that brings together various parties to deliver the strategy, achieve targets and desired outcomes, and support investors.

Adopting a whole-of-government approach to FDI attraction requires that all relevant governmental parties join efforts to achieve shared outcomes and create a favorable environment for investment through, for example, issuing harmonized policies, streamlining investment-related processes, unifying marketing and promotional strategies, developing capability programs, and offering comprehensive support and investment facilitation. The UAE exemplifies this approach through its NextGen FDI initiative, which aims to attract digital companies by providing an integrated package that includes banking, visa, and real estate services in a streamlined manner through public agencies' collaboration. This comprehensive government approach allows investors to benefit from consistent investment-related information and direction, streamlined investment processes, enhanced service delivery, and reduced bureaucracy, all leading to a more attractive investment climate.

Further to a whole-of-government approach, governments need to establish a robust governance model to oversee strategy execution with various vital layers and dedicated roles and responsibilities, including:

- A **national committee** to provide national oversight, direction, and support.
- A **central authority** to regulate and support investment activity, develop and oversee action plans, and maintain investment-related data (e.g., KSA's Ministry of Investment (MISA) or the UAE's Ministry of Investment).
- An **investment promotion agency** to support identifying, marketing, and promoting investment opportunities (e.g., Qatar's Investment Promotion Agency (IPA)).
- **Support committees with clear remits supporting tactical topics as needed and developing** competitive incentives related to FDI attraction.
- **An investment advisory council** composed of investors and public sector representatives to create open lines of communication and address ecosystem challenges.

F Example of a high-level suggested governance model



Source: Roland Berger

Select GCC countries like the UAE, KSA, and Qatar are already witnessing governmental restructuring, and data on FDI inflows reflect the positive impact these notable strides are generating. With FDI attraction becoming increasingly essential to developing national economies, many international governments will likely be reorganized and adopt a whole-of-government approach to create attractive investment climates and remain competitive.

3

Conclusion

FDI is increasingly becoming a cornerstone of national development strategies. Various governments, particularly those in the GCC, are directing significant efforts toward ensuring investment attraction and retention to drive economic growth.

A three-pronged approach has proven to yield success in buoying the growth and sustainability of FDI in various geographies, centering around:

- Crafting investment strategies with clear targets outlining the sought benefits, priority industries, and target home countries, in line with the country's overarching priorities
- Fostering an environment that is conducive to the growth of FDI, as well as introducing investment enablers that will render the host country more attractive for investment and provide support across the investment journey to facilitate and expedite investment attraction
- Supporting the strategy and the investment enablers by a robust governance framework -characterized by interagency collaboration and streamlined communication - that will allow for proper implementation and oversight of FDI attraction efforts.

Implementing the three pillars together in a coordinated manner will provide the foundation that is needed to attract and bolster FDI. That said, it is important that each of the three pillars are carefully defined on the back of research and studies that are specific to each host country and take into account its unique blueprint to truly ensure the success of FDI attraction efforts.

Looking forward, governments should:

1 Develop an **FDI strategy** with clear **desired outcomes** to define where to play across sectors, geographies, and source countries.

2 Ensure that **key investment enablers** are in place to create an environment in which FDI can significantly impact economic development and attract investors.

3 **Adopt a whole-of-government approach** and reorganize **governance models** to streamline collaboration and communication across key entities influencing FDI.

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