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The Determinants of GCC's Outward Foreign Direct Investment

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Abstract

Outward Foreign Direct Investment (OFDI) significantly impacts the economy of a country. This study aims to investigate the determinants of OFDI through the evaluation of outward investments for the panel of the Gulf Cooperation Council (GCC) countries. Pooled ordinary least squares (OLS), fixed effects and random effects regression analysis were applied to test the model and hypotheses. The data was collected from the year 1960 to 2018 from the databases of the World Bank and Bloomberg. GDPP (0.120, $p > 0.10$) has insignificant relationship with OFDI, whereas EX (-0.138, $p > 0.10$) has insignificant relationship with OFDI. However, INFRA (-0.001, $p > 0.10$) has insignificant impact on OFDI. In addition, ER (3.048, $p < 0.01$), has been found statistically significant at 99% confidence interval. The study revealed that FDI significantly impacts the economic performance of home and host countries. The rate of outward foreign direct investment has increased significantly over the past few years. It has been observed that the outflow has been on the rise from the developing states, where the factor has been identified as a strong influential element in the transition of economy.

Keywords: Determinants, Economic Development, Gulf Cooperation Council, Investment, Outward Foreign Direct Investment.

Introduction

The focus of the economies of the countries of Gulf Cooperation Council (GCC) including Kuwait, Bahrain, United Arab Emirates (UAE), Oman, Qatar, and Saudi Arabia, is entirely on oil sector. In recent years, the sharp reduction in oil prices has been observed on account of higher supply as compared to demand. Therefore, the GCC countries have endeavored to recover from the fallouts of this economic downturn. In 2016, GCC policymakers made foreign direct investment as one of the main plans to diversify the countries of GCC (Alharthi, 2018).

The Outward Foreign Direct Investment (OFDI) has been discreetly increased from the economic foundations of Gulf Cooperation Council (GCC) wherein, substantial amount of investment made in the service sectors. The GCC countries headed by Kuwait have documented around 89% of the OFDI, that amounts to the inflow of approximately 13 billion dollars. According to the estimates of UNCTAD, in 2014, Bahrain succeeded in exporting FDIs worth 957 million dollars which represents 2.2% of the

total FDI of Arab countries (Dhaman, 2015). Likewise, according to the estimation of UNCTAD, in 2014, FDIs worth 1180 million dollars were exported by Oman, representing 2.7% of the FDI of Arab countries (Dhaman, 2014). FDIs worth 10066 million dollars were exported by the UAE, that represent 22.9% of total FDI of the Arab countries for the same year (UNCTAD) (Dhaman, 2017).

The aim of the study is to address certain gaps in the literature regarding the determinants of OFDI by evaluating the outward investments for the panel of GCC countries. The evaluation FDI from the year 1960 to 2012 was carried out by extending the theory to the home countries and the determinants.

This study contributes to the related literature since it is the first study that aims to explain the determinants of OFDI in the GCC region after the implementation of new policy to adopt diversified economic programs using the longest balanced data set. Additionally, this work addresses the new OFDI challenges faced by the GCC such as modifications in oil markets and the global decline of FDI, as well as the shift to a digital economy. This region is very different from other developing countries on account of lower population and wealth in comparison with other developing countries. The specific contribution of this study to the subject of natural resources on the OFDI is to provide solid empirical evidence in a wider panel setting. Previous studies have two limitations, they often emphasize on single countries or a mitigated subset and investigate aggregate FDI inflows, irrespective of the bilateral nature of FDI. FDI inflows can affect OFDI with the corresponding potential endogeneity bias at the average level. Unlike other studies, this study delves into the factors that identify the development of new investment links at the country and regional level. This allows to provide a better understanding of the question of whether there is an oil curse on FDI in oil-producing countries. This study exemplifies how institutional reforms would influence the capacity of a country in attracting OFDI for different levels of oil production. In addition, the study infers the level of OFDI that would facilitate a country in overcoming the oil curse on FDI.

Surprisingly, oil reserves exercise a negative and significant influence on FDI, which might be due to the reason that countries with large oil reserves, such as the GCC countries, have sufficient financial resources to finance their own economic development (International Monetary Fund, 2016). This situation stimulates governments to set up limitations to protect their resources and to reduce the level of resource-seeking FDI. In addition, the relative reduction in OFDI inflows in GCC countries between the year 2008 and 2013 has been attributed to the increase in domestic investments. Gulf-based sovereign wealth funds have been proactively invested in their domestic public services (Toone, 2012). Some policymakers have progressively increased domestic investments to have better socioeconomic returns.

These findings suggest several policy considerations. Investment promotion agencies (IPAs) may wish to target not only traditional sources of FDI but also new sources such as OFDI of developing country. At the same time, policy makers may wish to review their countries' OFDI regulatory frameworks, given that undue restrictions may undermine the positive effects on the domestic economy. Policy makers may also wish to consider measures that enhance absorptive capacity at firm-level and economy-level to realize the full positive effects of OFDI in domestic economies. More policy-oriented research is clearly needed to help developing country official's better tailor and target future policy interventions.

The rest of the article is structured as follows: Section II reviews the literature. Section III presents the data and methodology implemented in this study. Section IV presents the empirical results. Section V summarizes the overall study.

Theoretical Framework and Empirical Review

Ownership-Location Internationalization (OLI) Paradigm

Dunning's (1981) ownership-location-internationalization (OLI) paradigm has been the focus of this paper, which indicates the presence of ownership, location, and internationalization benefits for a company to produce abroad. The ownership advantages of a firm are driven from its ownership of firm-specific intangible assets, which include skilled management, technology and patents. The foreign market must offer location advantages based on a large market size or cheap production for a company to produce internationally. The involvement of a firm in international production will mainly rely on the market based on subcontracting or licensing, as the transaction cost for doing subcontracting is higher than licensing.

The OLI theory mainly postulates that economic development, growth and prosperity occur due to the influence of external factors and indicators rather than internal factors (Mina, 2007). It has been manifested by the relevant literature that foreign direct investment leverages economic growth of the host country. Recent literature also substantiates the viewpoint in terms of GCC direct investment (Ayadi & Gadi, 2013).

Empirical Review

The empirical focus on the search of assets and advantages is more appropriate as compared to the asset exploitation-narrative to investigate the contribution of OFDI in the economic development of less advanced countries (Knoerich, 2017). This is because it allows the investigation of how the advantages or assets pursued such as resources, networks, factories, associations, technologies, and markets, etc. that encourage the development of host countries by means of direct transfer and utilization back in the host country (Carril-Caccia, Milgram-Baleix & Paniagua, 2019).

Cheap production, which is based on market size or labor, is facilitated by foreign markets due to major changes in the exploitation of the economies of scale. Economic policies and environment supportive of the exploitation of economies of scale are also provided by foreign markets (Gasaymeh et al., 2014). These factors include developed financial markets, political and institutional environment, exchange rate and tax policies, and trade. From the perspective of market size, almost all GCC countries are considered high income countries, with per capita Gross National Income of more than \$10,066 (Al Sadi, 2015). Outward investment is considered as a major contributing factor in the progress of a country. China is recognized as a resilient contender in this field owing to its sound strategic approaches in the market (Mina, 2010). Over the years, this country has made its market so firm that it can tolerate all type of pressure of the foreign investments; however, its investors show interest in the GCC market (Xia et al., 2014).

Several studies have quantified the effect of OFDI in the leading host countries of the world including Japan, European countries, and United States (Narula & Pineli, 2019; McGrattan & Waddle, 2020). This empirical review recommends that when a quantifiable effect is observed, it most often tends to be positive but small. It has been observed that OFDI improves output and growth, exports, productivity, employment, efficiency, and awareness in host countries (Delgado & McCloud, 2017; Zhou et al., 2018; Ibarra-Olivo, 2019; Li et al., 2017; Pun, 2020; Megbowon, Mlambo & Adekunle, 2019). These studies may only provide a restricted viewpoint since their emphasis has been on just a few economies and, therefore, they have data limitations which mainly emerge from the aggregate nature of some datasets. Nonetheless, these studies might recommend that similar effects must play a role in developing the domestic countries and this notion serves as a stimulation for the objectives

of this study. Surprisingly, explicit discussions have been restricted to a few rare exceptions and there is a lack of comprehensive empirical evidence.

Additionally, the example of OFDI shows specific agreement of a set of proposals which is given by the governments of GCC countries. In GCC countries, investors use merger & acquisitions often at the entry level of initial approach, probably because of the tough competition in GCC markets and also because firms of these countries seek innovative and well-known technologies and brands (Dowling & Vanwalleghem, 2018). In GCC countries, the Gulf investors favor some form of the organic development accomplished through Greenfield investments (GIs). Similarly, GCC countries offer critical benefits such as low-cost skilled employees and less entry obstacles for businesses investment (Ramady, 2014). Investments with controlled organizations by government are conspicuous and private Small Medium Enterprises (SMEs) dominate in several projects.

El-heddad (2018) examined the determinants of FDI for GCC countries during the time period from 1980 to 2013 by using fixed-effects model, generalized method of moments, and random-effects model. Findings of the study revealed that FDI was improved by the per capita GDP and showed that the investment in GCC is affected by higher production. However, the FDI was negatively affected by inflation. Yousef Alkhateeb & Farooqi (2018) emphasized on the contributing factors of FDI inflows by using annual data of Saudi investment from 1970 to 2015. The study has applied an auto-regressive distributive lag cointegration methodology and revealed that the FDI inflows are positively affected by the development of financial market and oil prices. The study has highlighted the impact of outward foreign direct investment in the stimulation of industrial upgrading with respect to the primary and secondary industry (Al-Samman & Mouselli, 2018).

Al-Shammari & Behbehani (2017) examined the home country determinants of OFDI for Kuwait for the time period from 1976 to 2011. The estimated models were investigated using Johansen cointegration test, granger causality test, and error correction technique. The study found that interest rate, public expenditure, and foreign direct investment were the main macroeconomic determinants of Kuwait's OFDI. Pauceanu (2016) examined the FDI promotion and its determinants in the Sultanate of Oman. The study showed that political and economic stability motivates foreigners to invest in the region. Furthermore, the study highlighted big market size, low business cost, and high purchasing power as favorable factors.

Similarly, Salem & Baum (2016) investigated the determinants of FDI for 8 countries in MENA region for the time period from 2003 to 2009 and showed that FDI is positively and significantly affected by regulatory quality and country governance indicators. It further showed that FDI is also insignificantly associated with voice and accountability, political stability, and control of corruption. In a recent study, Stoian & Mohr (2016) examined the determinants of OFDI of 29 emerging economies for the time period from 1995 to 2011. The results demonstrated that the inward FDI and GDP per capita have positive effects on outward FDI. However, infrastructures tend to have a negative effect. Based on the aforementioned review of literature, following hypotheses are proposed:

H₁: There is a positive association between OFDI and economic growth.

H₂: There is a positive association between OFDI and exports of goods and services.

H₃: There is a positive association between OFDI and fixed telephone lines.

H₄: There is a positive association between OFDI and exchange rate.

H₅: There is a positive association between OFDI and inflation rate.

H₆: There is a positive association between OFDI and labor costs.

H7: There is a positive association between OFDI and institutional quality.

Methodology

Sample Description and Data

A balanced panel dataset was used in order to investigate the determinants of OFDI in the GCC region. Data were collected from the six GCC countries: Oman, Qatar, Saudi Arabia, Bahrain, Kuwait, and the United Arab Emirates for the time period from 1960 to 2018. Panel data analysis is a frequently used technique in FDI studies as it allows the researchers to study the patterns of the FDI determinants for a short-time series. Panel data can improve the quality of data and sort out economic impacts that cannot be differentiated by cross-section or time series data alone since it combines both cross-sections and time series. Additionally, there are a number of data points that grant additional degrees of freedom which enhance the efficiency of the econometric postulations. Furthermore, the problems of the omitted or missing variables can be significantly addressed through the data of both the cross-section and time series effect.

The fundamental assumption of the constant coefficient model is that all coefficients, both the intercepts and slopes are constant with f as the error term. The constant intercept indicates that all economies are considered to be the same, and there are no substantial country-specific or temporal effects. However, it is assumed that the country-specific intercept a_j which is linked to the different economies may not be constant and may or may not modify over time. The effects of the omitted variables can be controlled by adding cross-section and/or period dummy variables in the model. The omitted variables are represented through the intercept a_j for every included country and indices. The intercept is allowed to be associated with the independent variables as follows:

$$y_{j,t} = a_1 D_j \dots + a_n D_j + \beta_i X_{j,t} + \varepsilon_{j,t} \quad (1)$$

The parts of the heterogeneity are observed through the $X_{j,t}$. The rest of the omitted variables consist of the error term $\varepsilon_{j,t}$. It may also be adequate to utilize a random effects model for improving the efficiency of the estimation process. However, the random effects model treats the intercept as the result of some distribution where each country has its own intercept through the inclusion of dummy variables. Only the mean effect from the time-series and random cross-section effects are included in the intercept term.

Model Specification

The focus of the study was on the home country drivers, which are the push factors for GCC countries to move abroad. The study used empirical analysis of the determinants of outward foreign direct investment from GCC countries by using pooled OLS (ordinary least squares), FE (fixed effects), and the RE (random effects) regression methods to estimate the relationship between the variables. In order to estimate the determinants of explanatory variables on outward foreign direct investment, a model was developed:

$$OFDI_{it} = \alpha_0 + \alpha_1 \ln GDP_{it} + \alpha_2 \ln EX_{it} + \alpha_3 INFRA_{it} + \alpha_4 ER_{it} + \alpha_5 Inf_{it} + \alpha_6 LC_{it} + \alpha_7 IQ_{it} + \varepsilon_{it} \quad (2)$$

Here, the dependent variable is the OFDI and Independent variables are GDP in natural logarithm form; EX in natural logarithm form; INFRA; INF is inflation; LC is labor costs; IQ is institutional quality; ER; α are parameters; and ε_{it} is an error term. The subscripts i and t represent country and time, respectively. ($i = 1, \dots, N$; $t = 1, \dots, T$) (Table 1).

[Insert Table 1 here]

Variables

In the baseline model, variables and proxies were considered as prescribed by the literature. The explanatory variables related to the GCC as a home country were grouped according to the local business conditions (level of economic development in natural logarithm form; exports in natural logarithm form) and infrastructure (official exchange rate). OFDI was the dependent variable in the study, which refers to net outflows as a percentage of GDP. Inward foreign direct investment enhances outward foreign direct investment as a proxy for business conditions, and refers to net inflows of foreign direct investment as a percentage of (GDP). It was used as a measure of the level of economic development in natural logarithm form. Exports enhance OFDI, and are also defined as an export of goods and services as a percentage of GDP in natural logarithm form. Infrastructure was measured as fixed telephone lines (per 1000 people). Official exchange rate was a control variable in this model. Annual data for OFDI determinants were extracted from the database of World Bank. The data released by the World Bank was utilized for calculating the real exchange rate and inflation. Finally, the data of institutional quality was extracted from the Bloomberg database.

Results and Discussion

Table 2 represents the summary statistics of data and shows the calculated mean values of dependent and independent variables. The net outflow of investment is indicated through negative sign of OFDI, which reports the economy to the world. However, the negativity of three components of FDI (intra-company loans, re-invested earnings, and equity capital) is indicated through the negative signs, associated with IFDI.

[Insert Table 2 here]

OFDI, GDPP, EX, INFRA, INFT, LC, and IQ, and ER were statistically insignificant at level; however, they were statistically significant at first difference. Hence, the variables were found stationary at 1st difference that means variables were co-integrated (Table 3).

[Insert Table 3 here]

Table 4 shows correlation among all independent variables. The highest value of correlation coefficient (r) was 0.927 between EX and Inflation, while lowest value of correlation coefficient (r) was 0.024 between Inflation and Exchange Rate.

[Insert Table 4 here]

Table 5 provides result of panel cointegration analysis. Augmented Dickey-Fuller (ADF) was found statistically significant at 95% confidence interval and, therefore, long-run relationship amid cointegrated variables were statistically proven by using (Kao, 1999) technique. Panel cointegration analysis was used on the basis of Pedroni (1999) technique for estimating long-run relationship among cointegrated variables. The statistics were estimated at 90% confidence interval.

[Insert Table 5 here]

Four statistics were found statistically significant at 95 percent confidence interval (Table 6). Hence, it was concluded that all variables were cointegrated and long run relationship was proven.

[Insert Table 6 here]

Table 7 provides results of pooled OLS analysis for estimating relationship between independent, dependent and moderating variables at 90 percent confidence interval. To check the cross-section dependency, Breusch-Pagan LM test was conducted and was found statistically significant. Therefore, Hausman test was conducted to see whether the Random effect or the fixed-effect would be applied.

In the above table, the estimation for Hausman (1978) test was found statistically insignificant at 90% confidence interval that provided that there was no misspecification of random-effect. Thereby, random-effect analysis was employed in the study for analyzing the relationship between predictors and outcome variables.

The results of Pooled Ordinary Least Square analysis showed that GDPP (0.120, $p > 0.10$) has positively insignificant relationship with OFDI, whereas EX (-0.138, $p > 0.10$) has negatively insignificant relationship with OFDI; however, INFRA (-0.001, $p > 0.10$) has negatively insignificant impact on OFDI. In addition, ER (3.048, $p < 0.01$), was found positive and statistically significant at 99% confidence interval. Moreover, all the independent variables had VIF coefficients lower than 5 and, therein, no multicollinearity was identified. Moreover, R-square was estimated as 0.183 at random-effect analysis providing 18.3% variability in dependent variable.

The finding shows that the influence of infrastructure on OFDI depends on the specification of the variables. No empirical evidence of any effect of infrastructure on FDI was found when fixed telephone lines were used as a proxy for economic growth. Therefore, infrastructure may be assumed a comparatively poor determinant of economic growth. The real per capita GDP constant was used for investigating the GDP per capita. Surprisingly, all the outcomes associated with the infrastructure that were obtained from the alternative model revealed that the real per capita GDP insignificantly influences OFDI. It is observed that foreign investors who intend to make profits prefer elevating economies to large ones. Moreover, it is assumed that the countries of GCC have begun to attract not merely resource-seeking FDI, but also market-seeking investors.

The findings confirmed the fourth hypothesis that exchange rate significantly influences OFDI. This outcome is in line with the findings of Al-Nasser & Gomez (2009), Vijayakumar, Sridharan, & Rao (2010), and Zhang & Daly (2011). The study attributed the quick increase of OFDI determinants towards the GCC region to the exchange rate policies implemented by the GCC countries variably since 1960 as part of the structural adjustment programs of the World Bank and the International Monetary Fund. Additionally, the institutional and legal modifications that have been implemented by the GCC governments in the past 15 years have positively influenced the increase of FDI in the GCC region. Nonetheless, liberal policies are undoubtedly important to attract FDI; the GCC countries have identified that these policies can be supplemented by strategies that protect local investors and assure lasting economic stability.

A number of oil projects in the GCC region have already been negatively impacted by adverse inflation rate. The fiscal squeeze induced by falling inflation rate is also likely to influence government spending, which is a major determinant of the construction market. Saudi Arabia and Oman have already reduced planned capital expenditures by 11% and 25% respectively in their 2015 budgets (Eissa & Elgammal, 2020) followed by budget reductions in other GCC countries that experienced the budget deficit for the first time in fifteen years.

Surprisingly, the labor costs have an insignificant relationship with OFDI inflows. It has been recommended by Cammett & Posusney (2010) that enacted provisions of labor recruitment and termination become more flexible in the GCC region as compared to those in oil-poor countries in the wake of boom in oil prices in 1974. In addition, the labor nationalization policies may have paradoxically been counterproductive to fight against the high unemployment rates in GCC countries in the early 2000s. Labor nationalization policies have enhanced job security and advantages to enhance the attraction of private sector jobs for people. This has facilitated GCC governments to reduce flexibility in the labor market in the private sector that reduces FDI inflows, and, therefore,

restricting the reduction in unemployment among residents. Firmness in the labor market institutions will mitigate inward FDI and elevate the total labor cost.

The rate of outward foreign direct investment has increased significantly over the past few years. The outflow has been on the rise from the developing states, where the factor has been identified as a strong influential element in the transition of economy. It is necessary to determine the physical capital available to the state as it is significant in providing economic growth. It is also important to evaluate the interests and needs of the local market that provides the outflow of investment (Alsadiq, 2013). It is absolutely necessary to identify the determinant of outward foreign direct investment to the countries with respect to all these circumstances. The determining elements are helpful for the investors to identify and define the best market for capital investment, and also facilitate the host countries in making their industries attractive. The maximum attraction from industries is helpful to gain major profit.

[Insert Table 7 here]

Table 8 shows causality analysis by using Granger (1969) technique and estimated at 90% confidence interval. The results of granger causality showed that relationship of GDPP, EX, INFRA, and ER are bidirectional, whereas GDPP with OFDI was in a unidirectional relationship where EX has been proven as lagging variable.

[Insert Table 8 here]

These positive contributions made by OFDI for development might be discussed in several ways, and there might be some adverse effects. In the first place, a number of less-advanced countries suffer from a shortage of capital, and OFDI may exacerbate such shortages as it involves an initial outflow of capital for an unpredictable time period. Domestic investment might be crowded out by OFDI, specifically if domestic firms have inadequate funds at their disposal. Over time, any initial shortages, however, will be reduced by the financial returns, which may particularly surpass and offset the initial capital outflow. Indeed, OFDI is linked with domestic investment in a condition of positive interdependence between them, and domestic investment may not be affected if firms possess adequate funds for both foreign and domestic investment.

The findings recommend that the devaluation of the domestic real exchange rate may attract more OFDI as it enhances the rate of return to foreign companies. The policymakers in the GCC countries should be aware of the fact that the advantages of this arrangement depend on different conditions. In the first place, the exchange rate depreciation should be associated with modifications in production costs and should attempt to balance increments in real wages in the target market. Outliers may play a fundamental role in the model as mentioned throughout the article; for instance, a substantial gap between Qatar and Bahrain was observed. Future studies should emphasize on the outliers and investigate approaches to reduce their impact. Additionally, more independent and control variables should be added including current account balances and population growth to enhance the potential of economic growth. Likewise, inflation data must be observed in the long-term since this paper covered only a period in which the GCC countries were facing instant economic growth.

Finally, OFDI in the GCC countries has mainly focused on the petroleum sector. The GCC countries have been striving to divert investment to the finance, infrastructure, and tourism sectors on account of the low exports and services and high level of dependency on hydrocarbon exports. Policymakers must focus on stabilizing macroeconomic determinants in the economy, which will diversify the foreign investment in other sectors, and boost a business-friendly environment. OFDI can be

supported by privatizing state-owned enterprises as it removes the constraints against private companies, which would diversify the economy.

Conclusion

GCC countries hold a small fraction of total OFDI in developing countries both in relative and absolute terms of GDP. UAE and Saudi Arabia have emerged as influential performers in comparison with other countries in terms of their responsibility to attract OFDI. Furthermore, during the 1990s, FDI inflows to the GCC countries did not increase which imply that the GCC had been lagging behind in promoting FDI. This negative trend might shift as more diversified developing countries are increasingly attracting FDI outflows. It is recommended that GCC countries should be selective when attracting FDI. GCC countries have much better financial resources and domestic investment to sponsor their development in comparison with other developing countries. The study has evaluated significant association among per capita GDP, infrastructure, business condition, and exports. The study has also identified that FDI has a significant impact on the economic performance of home as well as host countries. FDI does not contribute towards the domestic economic growth of the country when using its horizontal method to invest in the resources of foreign countries.

The strong complementary influence of OFDI makes it an exception tool towards private investment with significantly high coefficient by which the GCC countries can expand their economies and can boost domestic investors. OFDI can be better policy tool in the GCC countries for boosting private investment and diversify economic activities away from hydrocarbon. It has been observed that OFDI is a better tool for reducing the disparity between private and public investment in the GCC countries. The study also provides an interesting evidence-based policy implication for economies seeking FDI promotion. The specialized literature explains a growth in the extensive margin as the influence of FDI development through new investment partners. A robust negative effect was found of the oil variables on the extensive margin. On the contrary, this effect was not so robust on the intensive margin. These results recommend that the total value of investment remains comparatively unchanged, while oil-abundant countries attract fewer investment projects as compared to similar countries without oil.

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Conflict of Interest

The research has no conflict of interest.

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Tables

Table 1: Variables, Definitions, and Data Sources

Variables	Indicators	Definition
OFDI	Foreign direct investment, net outflows (% GDP)	A foreign direct investment is an investment in the form of a controlling ownership in a business in one country by an entity based in another country.
GDP	Real GDP per capita (2000 US\$) constant	Real GDP per Capita measures the average level of national income (adjusted for inflation) per person
EX	Exports goods and services % GDP	Exports are goods and services that are produced in one country and sold to buyers in another. Exports, along with imports, make up international trade.
INFRA ER	Fixed telephone lines (per 1000 people) Official exchange rate as a proxy for currency strength	- An exchange rate is the rate at which one currency will be exchanged for another. It is also regarded as the value of one country's currency in relation to another currency.
INF	Inflation rate	Inflation is a sustained increase in the general price level of goods and services in an economy over a period of time.
LC	Labor costs	Direct labor cost is a part of wage-bill or payroll that can be specifically and consistently assigned to or associated with the manufacture of a product, a particular work order, or provision of a service
IQ	Institutional quality	Institutional quality is a broad concept that captures law, individual rights and high-quality government regulation and services.

Sources: All data from World Development Indicators (WDI), (1960-2018).

Table 2: Descriptive Statistics

Variables	Mean	Standard Deviation	Min	Max
OFDI	1.367	2.456	-10.954	9.558
GDPP	35503.54	24996.93	731.067	112300.4
EX	64.280	18.814	16.209	133.921
INFRA	15.191	8.233	0.031	33.922
ER	2.067	1.766	0.268	4.761
INF	24.02	6.64	1.52	57.71
LC	62.04	17.74	0.00	100
IQ	10.05	1.01	7.87	12.11

Table 3: Panel Unit Root Analysis

		Levin, Lin and Chu				ADF - Fisher Chi-square			
		C		C & T		C		C & T	
		<i>I(0)</i>	<i>I(1)</i>	<i>I(0)</i>	<i>I(1)</i>	<i>I(0)</i>	<i>I(1)</i>	<i>I(0)</i>	<i>I(1)</i>
Bahrain	OFDI	0.660	0.000	0.108	0.000	0.436	0.000	0.503	0.000
	GDPP	0.133	0.000	0.982	0.000	0.785	0.000	1.000	0.000
	EX	0.155	0.000	0.449	0.000	0.130	0.000	0.193	0.000
	INFRA	0.456	0.000	0.686	0.000	0.182	0.000	0.500	0.000
	ER	0.162	0.000	0.399	0.000	0.192	0.000	0.225	0.000
	INF	0.125	0.000	0.133	0.000	0.417	0.000	0.099	0.000
	LC	0.463	0.000	0.139	0.000	0.474	0.000	0.319	0.000
	IQ	0.417	0.000	0.099	0.000	0.460	0.000	0.039	0.000
Kuwait	OFDI	0.361	0.000	0.610	0.000	0.227	0.000	0.073	0.000
	GDPP	0.300	0.000	0.529	0.000	0.791	0.000	0.900	0.000
	EX	0.677	0.000	0.522	0.000	0.588	0.000	0.372	0.000
	INFRA	0.379	0.000	0.352	0.000	0.533	0.000	0.180	0.000
	ER	0.020	0.000	0.777	0.000	0.772	0.000	0.344	0.000
	INF	0.125	0.000	0.131	0.000	0.471	0.000	0.159	0.000
	LC	0.436	0.000	0.193	0.000	0.447	0.000	0.391	0.000
	IQ	0.471	0.000	0.189	0.000	0.406	0.000	0.093	0.000
Qatar	OFDI	0.796	0.000	0.595	0.000	0.562	0.000	0.231	0.000
	GDPP	0.962	0.000	0.854	0.000	0.485	0.000	0.218	0.000
	EX	0.350	0.000	0.548	0.000	0.798	0.000	0.649	0.000
	INFRA	0.688	0.000	0.752	0.000	0.854	0.000	0.841	0.000
	ER	0.185	0.000	0.684	0.000	0.499	0.000	0.311	0.000
	INF	0.460	0.000	0.039	0.000	0.101	0.000	0.365	0.000
	LC	0.483	0.000	0.459	0.000	0.214	0.000	0.420	0.000
	IQ	0.101	0.000	0.365	0.000	0.073	0.000	0.157	0.000
Saudi Arabia	OFDI	0.755	0.000	0.229	0.000	0.549	0.000	0.449	0.000
	GDPP	0.394	0.000	0.978	0.000	0.438	0.000	0.914	0.000
	EX	0.473	0.000	0.054	0.000	0.616	0.000	0.519	0.000
	INFRA	0.021	0.000	0.694	0.000	0.089	0.000	0.333	0.000
	ER	0.193	0.000	0.876	0.000	0.534	0.000	0.622	0.000
	INF	0.406	0.000	0.093	0.000	0.110	0.000	0.356	0.000
	LC	0.438	0.000	0.495	0.000	0.241	0.000	0.402	0.000
	IQ	0.110	0.000	0.356	0.000	0.037	0.000	0.175	0.000
UAE	OFDI	0.203	0.000	0.011	0.000	0.683	0.000	0.635	0.000
	GDPP	0.699	0.000	0.816	0.000	1.000	0.000	0.467	0.000
	EX	0.237	0.000	0.674	0.000	0.002	0.000	0.448	0.000
	INFRA	0.811	0.000	0.400	0.000	0.856	0.000	0.034	0.000
	ER	0.222	0.000	0.458	0.000	0.056	0.000	0.301	0.000

	INF	0.073	0.000	0.157	0.000	0.261	0.000	0.745	0.000
	LC	0.261	0.000	0.745	0.000	0.422	0.000	0.030	0.000
	IQ	0.422	0.000	0.030	0.000	0.473	0.000	0.439	0.000
Oman	OFDI	0.085	0.000	0.816	0.000	0.271	0.000	0.519	0.000
	GDPP	0.488	0.000	0.885	0.000	0.334	0.000	0.230	0.000
	EX	0.972	0.000	0.822	0.000	0.687	0.000	0.231	0.000
	INFRA	0.077	0.000	0.472	0.000	0.775	0.000	0.502	0.000
	ER	0.685	0.000	0.955	0.000	0.259	0.000	0.343	0.000
	INF	0.037	0.000	0.175	0.000	0.216	0.000	0.744	0.000
	LC	0.162	0.000	0.457	0.000	0.412	0.000	0.031	0.000
	IQ	0.242	0.000	0.003	0.000	0.437	0.000	0.493	0.000

Table 4: Correlation Matrix

	GDPP	EX	INFRA	ER	INF	LC	IQ
GDPP	1.000						
EX	0.297	1.000					
INFRA	-0.173	-0.029	1.000				
ER	0.063	-0.024	-0.061	1.000			
INF	0.279	0.927	0.165	0.297	1.000		
LC	0.371	0.137	0.713	0.373	0.296	1.000	
IQ	0.360	0.036	0.603	0.363	0.172	0.265	1.000

Table 5: Kao-residual Panel Cointegration

	t-Statistic	Prob.
Augmented Dickey-Fuller (ADF)	-4.713	0.000

Table 6: Pedroni Panel Cointegration

	Statistic	Prob.
Panel v-Statistic	2.56	0.01
Panel rho-Statistic	-1.40	0.08
Panel PP-Statistic	-9.94	0.00
Panel ADF-Statistic	-9.94	0.00
Group rho-Statistic	4.08	1.00
Group PP-Statistic	-21.19	0.00
Group ADF-Statistic	-9.65	0.00

Table 7: Pooled OLS Analysis

	POLS	RE	FE	VIF
GDPP	0.120 (0.249)	0.120 (0.264)	-0.300 (-0.612)	1.224
EX	-0.138 (-0.606)	-0.138 (-0.642)	-0.368 (-1.556)	1.224
INFRA	-0.001 (-0.257)	-0.001 (-0.272)	0.003 (0.723)	NA
ER	3.048*** (6.080)	3.048*** (6.436)	5.916*** (7.808)	1.026
INF	-2.177 (0.249)	2.932 (0.264)	7.938 (-0.612)	1.019
LC	2.101 (0.294)	2.239 (0.246)	7.398 (-0.216)	0.191
IQ	-1.771 (0.429)	1.239 (0.426)	4.389 (-0.219)	0.121
Breusch-Pagan LM	209.057***			
Hausman Test	1.000			
R-Square	0.381	0.381	0.341	
Adjusted R-Square	0.106	0.106	0.276	

Source: Author's estimation

Dependent Variable: Stock market return

Asterisk in order of ***, ** and * represented level of significance of 1 percent, 5 percent and 10 percent respectively.

Table 8: Granger Causality

Null Hypothesis	F-Statistic	Prob.	Remarks
SMR does not Granger Cause GDPG	7.888	0.001	Bidirectional
GDPG does not Granger Cause SMR	4.296	0.015	
SMR does not Granger Cause INF	9.970	0.000	Bidirectional
INF does not Granger Cause SMR	2.662	0.073	
SMR does not Granger Cause OIL	9.622	0.000	Unidirectional
OIL does not Granger Cause SMR	0.740	0.479	
SMR does not Granger Cause REER	0.833	0.437	None
REER does not Granger Cause SMR	1.721	0.182	