

**THE ROLE OF FOREIGN DIRECT INVESTMENT IN ACHIEVING  
ECONOMIC DEVELOPMENT: THE CASE OF FOREIGN DIRECT  
INVESTMENT IN YEMEN**

**Yüksek Lisans Tezi (Master's Degree Thesis)**

**KHALED Waleed Baggash Haidar AL-ASBAHI**

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## ABSTRACT

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The primary purpose of this study is to describe and depict the status of FDI in Yemen. This study focuses on the role of foreign direct investment in Yemen as one of the most desirable sources of external funding nowadays. Also, the study sheds light on foreign direct investment in economic development. The descriptive methodology is used to meet the study's objectives, and data is gathered from publications, journals, international reports such as UNCTAD and The World Bank, and websites, mainly those run by Yemen's Central Bank and the Ministry of Commerce and Industry. The latest data available for FDI in Yemen was in 2019. Tables and visual graphs are illustrated to describe the status of the FDI inflows to Yemen and to compare Yemen's inflows with the global inflows and the MENA region. The study also explains the investment climate in Yemen, as well as the various obstacles Yemen faces. The study concludes that the volume of investments is modest and that its role in economic development is weak. This is due to the prevailing investment climate that was not ready to attract these investments, although the investment law included many advantages and exemptions granted to investment projects, and treated the foreign investor as the Yemeni investor, this law and its amendments did not lead to an increase in the volume of investments.

**Keywords:** Foreign Direct Investment (FDI), Economic Development, FDI in Yemen

## ÖZET

### **EKONOMİK KALKINMADA DOĞRUDAN YABANCI YATIRIMLARIN ROLÜ: YEMEN'DEKİ DOĞRUDAN YABANCI YATIRIM ÖRNEĞİ**

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Bu çalışmanın birincil amacı, Yemen'deki DYY durumunu tanımlamak ve ortaya koymaktır. Bu çalışma, günümüzde en çok arzu edilen dış finansman kaynaklarından biri olarak Yemen'deki doğrudan yabancı yatırımın rolüne odaklanmaktadır. Ayrıca, çalışma ekonomik kalkınmada doğrudan yabancı yatırımlara ışık tutmaktadır. Çalışmanın hedeflerini karşılamak için betimsel metodoloji kullanılmış ve veriler yayınlardan, dergilerden, UNCTAD ve Dünya Bankası gibi uluslararası raporlardan ve özellikle Yemen Merkez Bankası ile Ticaret ve Sanayi Bakanlığı web sitelerinden toplanmıştır. Yemen'deki DYY için mevcut en son veriler 2019 yılına aittir. Yemen'e DYY girişlerinin durumunu göstererek Yemen'in DYY girişlerini küresel girişler ve MENA bölgesi ile karşılaştırmak için tablolar ve grafikler kullanılmıştır. Çalışma ayrıca Yemen'deki yatırım ortamının yanı sıra Yemen'in karşı karşıya olduğu çeşitli engelleri de açıklamaktadır. Çalışmada, yatırım hacminin düşük olduğu ve ekonomik kalkınmadaki rolünün zayıf olduğu sonucuna varılmıştır. Bu durum, mevcut yatırım ortamının bu yatırımları çekmeye hazır olmamasından kaynaklanmaktadır. Yatırım kanunu ve değişiklikleri yatırım projelerine tanınan birçok avantaj ve muafiyetler içermesine ve yabancı yatırımcıyı Yemenli yatırımcı olarak ele almasına rağmen, yatırım hacminde artışa yol açmamıştır.

**Anahtar Kelimeler:** Doğrudan Yabancı Yatırım (DYY), Ekonomik Kalkınma, Yemen'de DYY

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## **Abbreviations**

FDI: Foreign Direct Investment.

OLI: Ownership, Location, Internalization.

UNCTAD: United Nations Conference on Trade and Development.

UN: United Nations.

IMF: International Monetary Fund.

WTO: World Trade Organization.

GIA: General Investment Authority.

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## **1 Chapter I: Introduction**

### **1.1 Problem Statement**

FDI has long been a major policy concern. Some of the problems on which policymakers typically must take a stance include the contribution of FDI to a country's external funding, economic growth, the actions of multinational firms, the degree of regulation of FDI, and other kinds of capital flows. The eighties of the last century witnessed a sharp decline in the volume of official development aid granted by developed countries to developing countries. The policy of fiscal deflation in developed countries to reduce the rate of inflation that appeared during the eighties led to a reduction in spending in these countries on foreign aid. Also, the international debt crisis that emerged in 1982 also led to a sharp decline in the volume of loans provided by international banks to developing countries. These and other factors paved the way for the influx of FDI into developing countries due to changing global economic conditions. on the one hand, and a change in the perception Through which developing countries look at the global economy, on the other hand. FDI is crucial for transmitting modern technology and methods, promoting capital accumulation, boosting the effectiveness of human capital, and growing knowledge and skills. In recent years, many developing countries have attempted to attract FDI by modifying their policies and offering incentives and a favorable climate.

FDI is currently seen as one of the most crucial elements of attaining economic progress. The positions of developing countries toward FDI have changed over the past three decades after they denied it for three decades due to their beliefs and ideologies, as well as claims that it violates their independence and sovereignty. As a result, developing countries started to pay attention to it and put a significant amount of effort and hard work into enticing these investments, based on the great hopes to overcome poverty and unemployment issues or at least mitigate them. In addition to enhancing the local business climate, the transfer of innovative technology from industrialized countries, and generating domestic investment. And it is essential to discover the effect of the country's investment climate and the political and economic conditions on the inflow of FDI. Yemen made numerous changes to the laws governing investments to promote and attract foreign investment per specific rules and controls to meet local financial needs and

transfer advanced expertise to its markets. It also paid tremendous attention to creating a more attractive environment for FDI. Despite all this, Yemen only attracted a small amount of foreign direct investment flows and fell short of expectations due to political and economic upheaval due to the erupted war, which is the problem that this study seeks to describe from different aspects.

## **1.2 Purpose of Study**

The primary aim of this study is to describe and depict the FDI status in Yemen and explain how the economic and political unrest has affected the FDI and economic development. Moreover, to provide a thorough theoretical framework for both FDI and economic development as well as the value these investments add to the targeted economy. Additionally, to explain the foundational elements of Yemen's investment climate as well as the legislation and laws that regulate FDI in the country. Finally, to present a descriptive analysis of FDI in Yemen. The study aims to find answers to the research questions.

## **1.3 Research Questions**

- 1- Is the investment climate in Yemen suitable for FDI?
- 2- How could FDI contribute to economic development in Yemen?
- 3- What are the obstacles to FDI in Yemen?

## **1.4 Scope and Significance of the Study**

The study aims to understand how foreign direct investments have affected Yemen's economy. It also provides a comprehensive image of Yemen's investment climate and analyzes the attractiveness of investments by outlining the country's natural resources. Additionally, the study illustrates tables and visual graphs of FDI inflows in Yemen. The study community will benefit from the research by taking advantage of the recommendations which will be reached by descriptive method.

The research significance lies in identifying FDI and the significant contribution that these investments can make to Yemen's economic development if the country can effectively plan, organize, and direct these investments, as these investments are a great

necessity for the country to meet its needs through the transfer of modern technology and capital.

As for the research objectives, they are:

- Identifying the volume of FDI inflows that Yemen has received until 2019.
- Describing the investment climate in Yemen and the natural resources Yemen possesses.
- Identifying the obstacles that hinder Yemen from receiving new FDI inflows for the past few years.
- Discussing how the political instability affected the FDI inflows.

Finally, this research will bring fresh knowledge to the investment and development sectors and help officials in charge to determine the priorities of involvement related to FDI and investment institutions that are being studied. The researcher also prospects this research will contribute to creating findings and recommendations that will be useful to other researchers that are interested in this field.

### **1.5 Research Variables**

The existence of FDI standards has a tremendous impact on developing nations, especially given the increasingly complex conditions. As a result, researchers in the field strive to produce standards to evaluate the extent to which FDI policies, practices, and applications exist in various nations. Additionally, the researchers have addressed a number of FDI-related dimensions pertaining to the facilities and incentives offered to investors by the host country as well as other elements that enhance the investment environment and encourage investors to function better. Furthermore, according to some experts, enhancing public safety requires concentrating on the investment climate component and creating measures that enhance protection.

The dimensions of FDI are similar for most researchers, despite the varied focal points that researchers have within the field. Depending on the various levels or characteristics of the location where the study is being conducted, this may involve adding a dimension or combining multiple dimensions into one dimension.

The following variables were employed for the purpose of this research Because they are comprehensive in nature and are frequently used, also they are considered to be more relevant dimensions given the nature of this study:

1- **Independent variables:** FDI dimensions, which are.

- Economic variables
- Political variables

**Dependent Variable:** Economic Development.

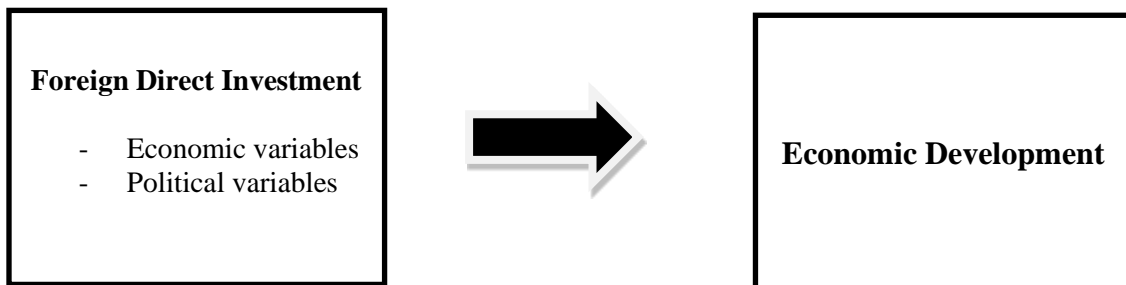


Figure 1.1 **Research Variables**

## 1.6 Previous Studies

Numerous studies have been done on FDI and how it impacts economic development. Here are brief summaries of a few of the noteworthy studies:

A study by the central bank of Chile (2003) emphasized that to encourage technological dissemination and the adoption of superior technologies, a well-educated workforce is necessary to reap the benefits of FDI fully. The same holds true for the exploitation of natural resources. The findings indicated that a high amount of human capital is advantageous. This avoids overcrowding among various activities. Also, it makes it possible for innovation to occur, starting in the field of natural resources and moving downstream to other sectors.

Maauia Hussein (2014) conducted a study on the impact of FDI and its correlation with the economic development in the Gulf Cooperation Council countries, the researcher

used modern growth theories, techniques, and statistical methods to investigate experimentally the connection between economic integration, growth, and FDI in the GCC nations. The results of the data analysis show the strength of the relationship between these variables, as FDI flows effectively support the economic development of these nations by assisting in the production of a variety of new goods that can enhance intra-trade and thereby promote greater economic integration among the GCC countries.

An article published by the European Journal of Development Research indicated that Although FDI may enhance productivity and exports, it is not always followed by a rise in the local economy's competitiveness or industrial capacity, two factors that, in the long run, drive economic growth. Without a domestic industrial sector with the required technical capacity to benefit from the externalities of MNE activity, FDI by itself does not offer growth potential.

### **1.7 Limitations**

By emphasizing both the geographical and human restrictions, the study's limitations can be stated in the following:

The research aims to identify the factors that help attract the FDI and describe how these investments can make an impact on the economic development in Yemen. However, the data collection process during the study will be challenging given the unstable political situation in the country.

The research covers the period from 1990 to 2019 and specifically focuses on that time frame because of a variety of factors, including the fall in foreign investment that occurred in the middle of the first decade of the twenty-first century as a result of political and economic changes. Beginning in the 1990s, the Yemeni economy also underwent fundamental changes, with a move toward a free market and a diminution in the role of the state. Yemen also experienced several political occurrences, the most notable of which were those that Yemen experienced in 2011 and the subsequent occurrences that have had an impact on and continue to have an impact on Yemen's political and economic stability as well as the business climate.

## **2 Chapter II: Literature Review**

### **2.1 Foreign Direct Investment (FDI)**

#### **2.1.1 Introduction**

In the early nineties, FDI began rising steadily. This has provided an incentive for economic researchers to study FDI and its influence on development outcomes. The effect of FDI can interact through a direct or indirect channel. FDI can enhance capital accumulation by increasing domestic investments in host countries. Moreover, FDI can enhance development in ways that go beyond the acquisition of physical capital. Farrell (2008) referred to FDI as a “package of capital, technology, management, and entrepreneurship which enables firms to function and sell goods and services in a foreign market”. FDI can be defined as a composite bundle that encompasses capital stock, modern technology, more sophisticated production techniques, managerial know-how, and proficiencies (Dowrick S. and Rogers M., 2002, P. 6).

Empirical evidence on the actual impact of FDI on development, using country-specific statistical data is quite contradictory. Several researchers have linked FDI productivity to the host countries’ intake capacity. Studies on the mediated impacts of FDI on development vary by country sample and period and generally reveal a strong positive or neutral link with the quality of the economic, political, and social environment, financial system penetration, and development (Hermes and Lensink, 2003, Durham, 2004, P. 33; Alfaro et al., 2006, P. 17).

FDI is hugely crucial because it is viewed as a collection of tangible and intangible assets, and the firms that deploy them are significant players in the global economy. There is currently tons of evidence emphasizing that FDI may contribute to growth and development in an economy through facilitating commerce, the transfer of knowledge, and technology, as well as by leveling up domestic investment. The New Partnership for Yemen's Development recognizes the significance of FDI because it sees it as a crucial resource for bringing Yemen's ambition of expansion and development to life. This is to ensure that Yemen, like many other developing nations, can leapfrog to a sustainable development rate and end its current level of poverty. To do this, Yemen requires a large

input of outside resources to close the savings and foreign exchange gaps (Sammer, 2019, P. 2).

The majority of the fast-growing economies, except for a limited number of countries, significantly relied on FDI to kick-start and maintain their rapid economic transition. Many developing countries, like Yemen in particular, are looking for such investments to speed up their development efforts due to the potential role of FDI in speeding growth and economic transformation. Thus, encouraging, and luring FDI has grown to be a crucial part of the development paradigm approach for developing nations. In the case of Yemen, the importance of FDI as a source of capital has increased due to its potential to close the savings-to-investment gap as well as to provide the necessary resources for the achievement of the Millennium Development Goals (MDGs). The poverty MDG is crucial for Yemen because of the region's extreme and pervasive poverty. Not only may FDI boost GDP, but it can also create jobs, which is one way it can reduce poverty. Multinational corporations' employment "boosts domestic wages, enhances domestic employment, encourages the transfer of technology between foreign and domestic enterprises, and increases labor force productivity." Given the country's low income and weak local savings level, its resource needs, and its limited capacity to raise funds domestically, the majority of the region's funding for the future would have to come from abroad (Asiedu, 2004, P. 55).

In addition to enhancing its investment environment Yemen has implemented a number of steps in an effort to attract FDI to its economy due to the importance assigned to FDI in the growth and development process. To guarantee that resources are allocated to areas and sectors where they are desperately needed to address the concerns of employment creation and poverty elimination, the country has adopted a variety of incentives. As governments compete for FDI, there is sometimes a risk of a "race to the bottom." It is unclear whether FDI is being drawn to the businesses and sectors that will have the biggest positive ripple effects on long-term development and indirectly fight poverty. It is not frequently understood that each country must meet a certain level of absorptive capacity in order to get the most from the spillover effects of FDI. The right policies are therefore important in order to take advantage of this aspect of globalization (Ajayi, 2000, P.5).

The MDGs' emergence in 2000 brought policy attention to the resource gap that Yemen must close in order to escape its savage poverty. Attracting FDI has taken on a greater pride of place than before in the strategies for economic renewal being undertaken by policymakers at all levels in response to the inadequate resources needed to finance long-term development in Yemen and the need to meet the Millennium Development Goals. The experiences of a few rapidly developing newly industrialized countries in East Asia have supported the notion that obtaining FDI is the key to closing the resource gap. FDI is given a lot of attention because it is anticipated to increase production as well as create jobs and empower the underprivileged (Prosper Ngowi, 2001, P. 13).

Under the framework of development thinking, the aim to entice FDI to Yemen is nothing new. Yemen seeks FDI because of the predicted boost to its economy that it will provide. It may surely be able to address two of Yemen's main issues, notably the savings gap and the lack of technology and skilled labor. So, FDI comprises not only financial capital but also administrative and technological know-how, which can raise productivity. So, Yemen has to make progress in raising its FDI level. After achieving unity, Yemen enacted policies with extensive incentive programs to entice FDI (UNCTD 2005). The concept that foreign investments result in externalities like technology transfer and spillovers serves as the economic justification for the incentives to draw FDI. The economy as a whole may be significantly impacted by the transfer of technology (Carkovic and Levine, 2004, P. 4). Once the commercial bank credit dried up and there was a debt crisis in the 1980s, it was believed that the analysts of the structural adjustment plan that expanded FDI were crucial to a long-term economic recovery. From this angle, it was anticipated that the adoption of good fiscal policies along with an accelerated rate of liberalization, deregulation, and privatization would bring FDI to Yemen (World Bank 1997:51, IMF 1999).

Hong (1997) conducted a study on Korea to clarify the influence of commercial loans and FDI on factor productivity between (1970-1990) and noted that there is a more favorable and significant impact of FDI than commercial loans on factor productivity. The study also demonstrated how the private sector in Korea benefited significantly from FDI, particularly in capital-intensive sectors like electronics, oil, and machinery, which improved the trade balance and consequently the balance of payments. Chen and others

explained in their 1995 study on the significance of FDI in China that its contribution to raising Chinese exports increased from (3%) in 1984 to more than (5%) in 1988, and (12%) in 1990, approximately (17%) in 1991, and (20%) in 1992, and reached (30%) of Chinese exports in 1993 due to the availability of many ingredients in China, the most important of which is the adoption of the industrialization strategy in order to export (Hong, 1997, P. 10).

### **2.1.2 Meaning and Definition of FDI**

FDI is defined as an investment that involves a long-term relationship and shows a persistent interest and control by an owner of the entity in one economy, also known as a foreign direct investor or parent enterprise, in an enterprise existing in another economy than the foreign direct investor's enterprise or foreign affiliate. It also indicates that the investor has significant management influence over the company located in the other economy. The primary transaction between the two entities as well as all future transactions between them and their respective overseas affiliates, both incorporated and unincorporated, are included in this investment. FDI can be carried out by both private individuals and corporate organizations (OECD, 1996, P. 246).

FDI flows compose of Capital contributed to an enterprise by a foreign direct investor (directly or through other associated enterprises) or capital acquired by a foreign direct investor from an investing entity. Therefore, we can identify the components of FDI as Equity capital, reinvested earnings, and intra-company loans (IMF, 1993).

- Equity capital refers to the purchase of shares of a company by a foreign direct investor in a country other than their own country.
- Reinvested earnings are Earnings that affiliates do not pay as dividends or that are not remitted to the direct investor and make up the direct investor's portion of reinvested earnings (in proportion to direct equity participation). Affiliates invest such residual earnings.
- Intra-company loans are Short- or long-term borrowing and lending of money between direct investors (parent firms) and affiliated businesses which are referred to as intra-company loans or intra-company debt transactions.

FDI stock is known as the value of the portion of their capital and reserves that are attributable to the parent company, as well as the affiliate's net debt to the parent company. Due to the fact that these definitions frequently do not apply to disaggregated FDI data, FDI flow and stock data used in WIR are not usually described as above. For instance, data based on FDI approvals can also be utilized to analyze geographic and industrial trends and patterns of FDI. Because they enable disaggregation at the country or industry level ((OECD, 1996, P. 248).

### **2.1.3 The Concept of FDI**

Foreign investment refers to capital flows from one country to another, which contributes to granting foreign investors shares in local companies and institutions. Foreign investment is perceived as a catalyst for long-term economic growth for countries, especially with the increasing globalization in the period. Finally, companies have many branches in many countries around the world, and this reflects the role of foreign investment as part of local investment that enables the foreign investor to influence business strategy in different countries (Investopedia, 2011)

Domestic capital is insufficient to support the development of nations that aspire to compete in global markets. Foreign investments that come in the form of capital or debt have been a crucial source of funding and a vital part of developing countries' financial resources. these investments can help them manage their debts and build their infrastructure. Throughout history, developing countries and states have sought foreign investment to strengthen their economies and improve their infrastructure. As a result, countries had to rely on foreign investors to fill a variety of needs and requirements the host countries lack or have limited access to, such as technological infrastructure, capital, and expertise (Salacuse, 2019, P. 47).

The argument that states investments that remain inside the home country would be beneficial for the development of the home country is no longer true. In terms of workforce, access to raw materials, and exposure to new markets, foreign investment has emerged as a crucial component of state growth. Foreign investors are regarded as essential in terms of funding and technology transfer for the completion of high-cost and specialized energy, infrastructure, and natural resource initiatives (Vig, Z. 2019, P. 11).

#### **2.1.4 Historical Background of FDI**

The significant accumulation of capital in global financial hubs, which is significantly greater than the potential for domestic investments, has immensely driven international investment to extend worldwide. The development of FDI played an essential role in extending the European empires globally. It is well known that foreign investment in Europe has a long history, in which these investments were landed on different continents (Sornarajah, M. 2010, P. 4).

One of the oldest examples of FDI in its clearest form is the Phoenicians, which is a civilization that thrived during the period of 1500 BC, which is nowadays known as Israel's occupation and occupied Palestine. The Phoenicians constructed outposts around the Eastern Mediterranean from which they could sell merchandise from their native countries, such as textiles and wood, and also conducted trade with the Greeks via ships (Weiniger, M. 2010, P. 3).

Western European states started establishing permanent colonies in the better places they had previously visited due to trade missions at the beginning of the 15th century and onward. The Dutch East India Company, the first international organization in history, was established in 1602 to pursue commercial activities in Indonesia. The Portuguese, together with the British and French, start colonial ventures in Africa and India. Moreover, the latter two states established colonies in North America, where fur hunting was a lucrative industry. By the mid-17th century, Portugal and Spain had also started to settle in Central and South America, motivated by their desire to find gold (Collins, D. 2017, P. 6).

Investments were pervasively made during the 18th and 19th centuries in the context of colonial expansion. During this time, the imperialist governments made

their investments unilaterally in the colonial states, most of which focused on natural resources that are available in colonized countries. The European powers' practice of colonialism was motivated by the need to take advantage of the cheap labor and bountiful resources that existed in underdeveloped countries. Military and administrative presence was used to accomplish it (Collins, 2007, P. 7-8).

A significant portion of the global infrastructure was built through FDIs at the beginning of the 20th century, including electrical power in Brazil and telecommunications in Spain. For example, American automakers before World War I, and German chemical industries were also expanding abroad. Also, British businesses started by investing in consumer product production abroad (Twomey, M. 2000, P. 55).

### **2.1.5 Theories of FDI**

Foreign investment theories have undergone significant developments in line with developments in international trade and economic events that the world is aware of every day, starting with the classical theory and ending with the modern theories, through classical and neoclassical theory and its development. Due to the dual effects of this economic phenomenon on the mother country and the host countries, there are numerous theories that attempt to explain foreign direct investment. Each school that considered this topic had an interpretation that was compatible with the underlying presumptions (Denisia, V, 2010).

#### ***2.1.5.1 The Classical Theory of Foreign Investment***

International trade begins mainly with the neoclassical theory developed by Smith in 1776 and later expanded by Ricardo in 1817. The basis of this theory is that if each country focuses on producing goods and services that have an advantage, all countries will Make profits even in cases where some countries have more resources than others. Many of the classical economic thinkers, in their analysis of foreign direct investment, proceed from some assumptions, including the full market, the absence of state intervention, and the existence of complete freedom for the movement of capital and production factors. The classic assumes that FDI entails many benefits, most of which are attributed to multinational corporations. Investments, from their point of view, are like a

one-sided match, as the winner is the multinational companies, not the host countries (Al Kahaf, 2003, P. 411).

### **2.1.5.2 Factor Proportion Theory**

Factor proportion theory endorsed by Hecksher and Ohlin in 1933, focuses on the observation that countries tend to specialize in the production of goods and services that depend on the availability of their resources in that same country, and the determinants of the pattern of trade are the factors of production in their entirety, which in turn influence trade and international investment. As a result, some economists updated these theories according to the variables of the global economy and market, most notably the theory of Vernon in 1966-1971 and Wells in 1968-1969, who worked on putting the classical theories in their modern perspective, so the product life cycle theory appeared (Casablanca, 2004, P. 199-200).

### **2.1.5.3 Product Life Cycle Theory**

To address the apparent inability in explaining global trade and foreign investment, the product life cycle theory was introduced by Vernon 1966-1971 to address the implications of abundance and size. The product life cycle theory states that when a company begins to export its products and subsequently makes a FDI in the country to which it has been able to export, this product moves through a life cycle that passes through three stages:



**Figure 2.1** Product Life Cycle

The high cost of labor plays a role in introducing new products, also the free movement of inputs or factors of production, which may be necessary for the first stage, as well as effective communication between the product, customers, suppliers, and competitors. In the product maturity stage, the company invests directly in production in host countries where production is relatively insufficient compared to demand. This

would affect two of the characteristics of this stage, according to Vernon, a decrease in the need for flexibility and a growing concern for cost rather than product characteristics. In the standardized product stage, and in response to increased competition and pressure to reduce costs, it becomes necessary to establish companies to achieve low costs in developing countries to serve markets around the world (Charles, 2007, P. 168).

#### ***2.1.5.4 Imperfections Market Theory***

Competition is perceived as one of the most crucial factors on which companies are based, so if the company is unable to compete in the market, then this leads to its demise, which is the basis this theory is based on. As we assume the absence of perfect competition in the markets of developing or host countries, in addition to the great shortage of Commodity supply that can be an advantage for foreign investments. Also, the national companies in the host countries do not have the ability to compete with foreign companies in various economic fields, or even about the requirements for practicing any other functional activity of business organizations, i.e. the availability of some capabilities or strengths of the multinational company, such as financial resources, technology, and administrative skills Compared to national companies in host countries is considered one of the main factors that drive these companies towards foreign investments. In other words, the certainty of these companies that national companies in the host countries will not be able to compete with them technologically, productively, financially, or administratively will be one of the main incentives behind these companies' decision to invest or engage in any production or marketing activities in developing countries (Market Imperfections Theory & Foreign Direct Investment, 2016)

Hood and Young emphasized that the case of imposing the rule of perfect competition in foreign markets would decrease the ability of the multinational company to influence or control or even ensure a permanent and effective position in the market. Where there is complete freedom for any investor to enter the market, the goods and services provided, as well as the inputs, components, and elements of production used are characterized by homogeneity. Therefore, there may be no competitive advantages for the multinational company in front of its rivals in the host countries in this type of market (Article, a dynamic growth engine for emerging economies, 2007).

Parry and Caves agree with Hood and Young in this regard, as FDI is closely related to the availability of some advantages or possession of some distinct or absolute

characteristics and resources with the multinational company compared to its national rivals in the host countries. This means that the motive behind the investment decision is The monopolistic advantage that multinational companies enjoy and that they can benefit from in the host countries, we can say from this standpoint that the evasion of multinational companies from full competition in the national markets of the mother countries and their tendency to invest or transfer some of their activities to the markets of developing countries can happen in all or some of the following cases (Hadji, 2017).

- The existence of intrinsic differences in the products of the multinational company compared to other national or foreign companies in the host countries, i.e., qualitative differences.
- Availability of distinct management, marketing, and production skills among multinational companies over their rivals in host countries.
- The enormous size of the multinational companies and their ability to produce in large volumes, in which case they can achieve economies of scale.
- The difficulty of customs protection procedures and policies in the host countries may result in the difficulty of exporting to these countries, and then direct or indirect foreign investments in the form of production licenses become the available or best method for conquering such markets.
- The governments of host countries grant privileges and customs, tax, and financial facilities to multinational companies as a means of attracting foreign capital.

### **2.1.5.5 Eclectic Paradigm Theory**

According to J.H Dunning, the eclectic paradigm is an economic and business method for analyzing whether making a FDI is appealing. The eclectic paradigm is also renowned as the ownership, location, and internalization model (OLI) framework. It is widely used when companies assess the country, they aim to invest in. This paradigm presumes that institutions will avert transactions in the open market if the cost of carrying out identical tasks internally is less expensive (Maitena and Banco, 2003, P. 3).

- **Ownership Advantage**

The competitive advantage that comes with FDI can also be perceived as the ownership advantage. In this case, ownership might be characterized as the possession of a special and valuable resource that is difficult to duplicate, giving the owner a competitive advantage over possible foreign rivals. The inherent disadvantages or difficulties associated with FDIs revolve around the obligations of being foreign since the potential investor is not a citizen of the nation where the FDI will be made. The challenges can include potential language barriers or a lack of understanding of the typical demand patterns of the regional consumer markets.

In order to balance out the liabilities above, firms and their management teams typically need to consider the potential for transferring the competitive advantage to other foreign markets. An ideal investment should have significant economies of scale, a solid track record, a well-known brand name, and cutting-edge technology (Verbek and Yuan, 2010).

- **Location Advantage**

Location is one of several competitive advantages that the prospective business host countries for FDIs must demonstrate. The geographic advantages of the host country or countries are more prominent in the location advantage. Access to the ocean (for easy sea freight) is an example of a geographic advantage compared to a landlocked country. Low labor and raw material costs, lower taxes and other tariffs, and a skilled labor force, etc. are some further location advantages. Investment companies and their management teams should consider whether any of the location advantages exist in foreign markets (Zhao et al., 2003, P. 303).

- **Internalization Advantage**

The management team of foreign companies must evaluate the internalization advantage before deciding which investment method or strategy is optimal for their objectives and needs. Typically, they should determine if it would be more prudent to outsource the value chain activities to a foreign nation or have it done locally by their team. Lower prices, better skills to carry out value chain activities, and better familiarity with local markets can all be advantages of outsourcing to other countries (Palgrave, 2001, P. 395).

Management in this situation has two choices on how to move forward. either it licenses its product design to a stand-alone foreign firm, or it can outsource production to an original equipment manufacturer (OEM). If companies do so, then, they should maintain control over their operations and engage in FDI by establishing an entirely new business entity (greenfield investment), forming a partnership with local partners, or acquiring an existing local company (Palgrave, 2001, P. 413).

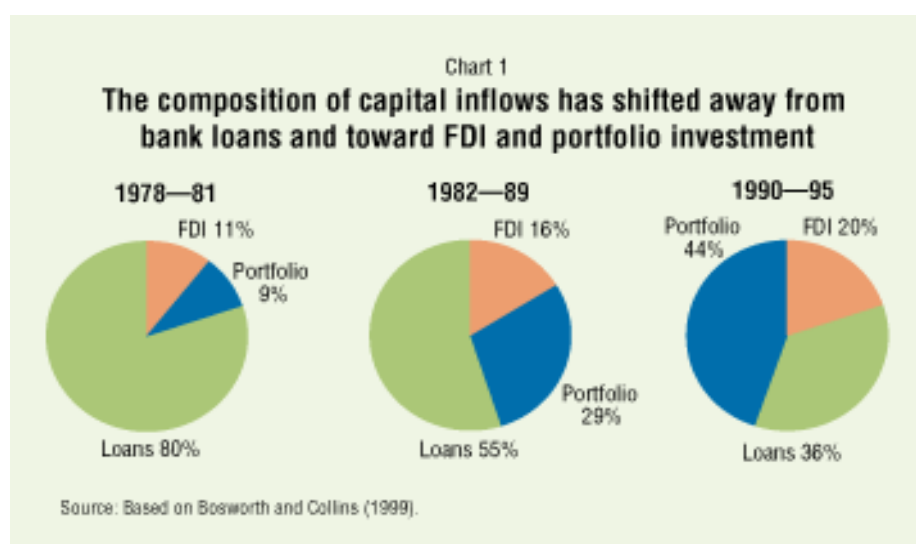
### **2.1.6 Importance of FDI**

FDI spurs economic development, and it is a country's main source of capital inflow and growing earnings. It frequently leads to the establishment of factories in the investing country, where local resources, including materials and labor, are utilized. This procedure continues Based on the employee's ability levels. moreover, it leads to more work opportunities. A country's service and manufacturing sectors benefit as FDI rises there, especially in developing nations, and this in turn contributes to the creation of jobs. In turn, employment generates new sources of income for a large number of people. Then, people spend their money, increasing the country's purchasing power (Paul Krugman, 1998.).

The development of human resources is aided by FDI, particularly if best practices, such as technology, and training are transferred. The personnel, often referred to as the human capital, receive proper training and development of their abilities, which contributes to an increase in their general knowledge. The process is reliable. It gives the nation where the investment is taking place a number of tools that they can use to their

benefit. For example, when FDI happens, the recipient enterprises are given access to the most recent tools in finance, technology, and operational procedures (Ong-Waha Lee, 1998, P. 114).

A few others that we cannot overlook are in addition to the ones mentioned above. For instance, FDI aids in the development of a country's underdeveloped regions and aids in its transformation into an industrial zone. Products made by FDI may be sold domestically and internationally, adding a crucial new source of income. FDI boosts a nation's capital inflow, exchange rate stability, and market competition. Lastly, it facilitates the smoothness of international affairs (Burji & Bouasha & Mubarak, 2013).



**Figure 2.2** FDI Inflows and its Impact on Loans

Economists frequently support the free flow of capital across international borders. Because it enables capital to seek the highest rate of return. Unbounded capital flows may also give a number of additional benefits (Graham, 1995).

As shown in Figure 2.2, first, FDI enables lenders and investors to diversify their lending and investment portfolios, foreign capital flows help to lower the risk that capital owners experience. Second, the propagation of best practices in corporate governance, accounting principles, and legal customs may be aided by the global integration of capital markets. Third, the ability of governments to implement harmful policies is constrained by the worldwide mobility of capital (IMF Website,2001).

### **2.1.7 Goals of FDI**

FDI has several goals and objectives that aim to attain, and we can divide these goals into two main pillars (economic and political), but we will only look into the economic goals side which can be stated as follows:

- Sales growth.
- Resource acquisition.
- Diversity.
- Lowering the competitive risk.
- Provide employment opportunities and lower unemployment.
- Increasing the rates of capital formation of the country.

Due to the advantages gained, particularly the low cost of the labor force component, low transportation costs, or the abundance of raw materials, it is focused on generating profits in the country hosting the investment, which typically exceed the profits obtained from investing money, time, and technological expertise in the home country of this investment. Raw materials, financial and tax infrastructure, and the availability of new markets to sell the investment's outputs (Sabri, 1999, P. 249).

FDI may contribute to raising the level of investment and, consequently, the GDP and employment in the host country. Also, it makes it easier to transfer technology to the recipient countries. In addition to having the potential to generate revenue for the host country's government through taxes on the revenues of international corporations or royalties from concession contracts. The ability to utilize the profits from direct investments to pour back into expansion, modernization, and development of associated industries. Moreover, expert management and advanced management techniques, it can spark a managerial transformation in the host country.

With the help of foreign capital, the government might be able to boost exports while lowering import demands, which would lessen the BOP imbalance. It may be able to

advance competition and dismantle domestic monopolies in addition to the objectives of international investors. The social returns on foreign investment are higher than private returns on foreign investment if FDI increases output in the host country by more than the return on foreign capital. To fulfill the objective of national economic development, bringing capital and foreign exchange can help close the savings and foreign exchange gaps. Also, this could encourage domestic businesses to work with international businesses to invest in auxiliary sectors. (Tamil Nadu, 2002, P. 151).

### **2.1.8 Determinants of FDI**

Since maximizing profits is the main objective of FDI in developing countries, this investment must consider the determinants, constraints, or barriers that affect the attainment of this objective. These determinants can be explained by the following:

- The cost of production inputs, particularly the wages of the labor force. When this cost is high, it serves as a deterrent to investment; conversely, when it is low, it provides an incentive.
- The component's labor force productivity. FDI is attracted when this productivity is high, and the opposite is true when it is low.
- Economic growth rates, when they are high, they stimulate foreign investment, whereas when they are low, they restrict it.
- The rates of monetary inflation, FDI is hindered by the high rate of monetary inflation but is encouraged when this inflation is desired.
- The small size of the market can be a factor that discourages foreign direct investment, because individuals in developing countries have low incomes. On the other hand, when the market is huge, this investment is urged.
- The high volume of exports in the country's trade balance draws foreign direct investment. In contrast, when this balance is in a state of deficit, it becomes an impediment element for this investment.

- FDI is not encouraged by trade restriction policies and economic centralization, and the opposite is true when these policies are in place. When these policies are trade liberalization, reform, and openness to the outside world, these are aspects that stimulate this investment.
- Increasing the country's debt to the outside world or international organizations like the International Monetary Fund and the World Bank, as this indebtedness places restrictions on this investment. Additionally, this country must pay some of its debt (installments and interest) at specific times, which makes this country helpless to pay that off. Therefore, the country resorts to rescheduling the debt, which constitutes a heavy burden on the balance of payments and thus restricts the movement of foreign capital to it.
- The deterioration of the economy's infrastructure, such as roads and means of transportation, represents a limitation to this investment, and vice versa when the country has an integrated infrastructure.
- Low-interest rates and poor banking services in commercial banks do not aid in bringing in foreign direct investment; on the contrary, if these rates increase, it is advantageous to attract this investment.
- When political and security stability is weak, it affects this investment, and when it is strong, it has the opposite of the desired effect.

So, it is obvious that economic factors, commercial and economic policies, and political and security factors all affect foreign direct investment, either determining or restricting it or enticing it to operate in emerging economies (Mufeed Yunus, 2006, P.103).

### **2.1.9 Types of FDI**

The investment market spans a wide area. Both small and large investors can make investments in domestic and foreign businesses. FDI is deemed as an investment made by one company in another company operating in a foreign country. Foreign direct investments come in four main types (Hanti, & Ahmed, 2020, P.66).

#### **2.1.9.1 Vertical FDI**

FDI is typically divided into vertical and horizontal categories. With vertical FDI, the production chain of the corporation is geographically decentralized, with overseas affiliates in developing countries often producing labor-intensive intermediates that are delivered back to developed countries with high wages, frequently to the parent corporation itself. Since the primary goal of the investment is to raise the production efficiency of the firm, vertical FDI is frequently referred to as "efficiency seeking" FDI. Global supply networks are typical, for example, in the textile and apparel industries. The stages that require a lot of capital (raw materials) are found in relatively capital-rich countries, the stages that require a lot of human capital (design and high-end packaging) are found in countries with plenty of human capital, and the stages that require a lot of labor (biscuits) are found in countries with plenty of labor. The electronics sector, which has had a significant impact on Malaysia's industrialization, is another sector where the production process can be easily divided into phases with varying levels of factor intensity (Allan and Unwin, 2002, p. 95).

It is common to refer to a certain subset of efficiency-seeking FDI as "technology-seeking" FDI. In this instance, the location's appeal is due to its exceptional skill rather than its low cost of labor. Investment from developed countries is likely driven by cost-effectiveness and access to a cutting-edge IT environment. Bangalore, India, is frequently referred to as the Silicon Valley of Asia. India actually possesses the second-largest pool of IT experts in the world, after only the US in size (Bjorvatn, 2001, P. 73).

### **2.1.9.2 *Horizontal FDI***

The term "horizontal FDI" refers to the type of FDI made across industrialized countries in order to get around trade restrictions, acquire access to the local economy, or access local technical skills by settling close to other existing businesses. A company extends its domestic activities to another country. In this instance, the company carries out the same operations, but in a completely different country. Burger King opening restaurants in Saudi Arabia, for instance, would be regarded as horizontal FDI.

Horizontal multinational enterprises serve local markets by producing the same goods in a number of affiliate facilities, instead of exporting goods from their home country. Global FDI is primarily horizontal. For example, Brainard 1997 claims that only 2% of the output created by international affiliates based in the United States is sent to their parent businesses, while as low as 13% of the overseas production of U.S.-owned foreign affiliates is exported back to the United States (UNCTAD, 2001, P. 33).

The term "market-seeking" FDI is sometimes used to describe horizontal FDI. Being close to the clients has several benefits, which may include lower transportation costs, fewer cultural barriers, or the minimization of tariffs. Several countries have consciously exploited trade policies to draw in foreign investment. By imposing high tariff barriers, they have made it more lucrative for foreign companies to establish regional headquarters than to sell by exporting to the market. There is no trade-off between trade and domestic industry for certain types of non-tradable services; rather, market entry simply calls for FDI or other contractual arrangements for domestic production. Examples of these sectors include hotels, real estate, retail trade, and a portion of the telecommunication, banking, and financial sectors. With over 50% of global FDI stocks and an even bigger share of FDI flows in 1999, FDI in services has grown in significance over time. (Ismail, 2001, P. 63).

### **2.1.9.3 *Greenfield FDI***

A greenfield investment is a business venture that entails establishing a new company abroad. With a greenfield investment, the parent company aims to establish a new company, typically using its branding. Greenfield investments can be made to target clients in another country, or they can involve hiring workers and creating facilities to

lower a company's overall expenditures. Foreign direct investments are another name for greenfield projects (FDI). With a greenfield investment, regardless of its parent firm affiliation, the new company is normally required to abide by all local regulations. The absence of potential acquisition targets in a foreign nation is one of the main justifications for conducting a greenfield investment. As an alternative, a business may discover opportunities for purchase but recognize significant challenges in merging a parent firm with a target. When beginning a business from scratch in a new nation, a greenfield investment could be the best course of action because many nations offer subsidies, tax exemptions, or other advantages to entice FDI (UNCTAD, 1994, p. 83).

#### ***2.1.9.4 Acquisition FDI***

The acquisition of shares in an established foreign corporation is referred to as an acquisition. Acquisitions have accounted for the majority of the growth in FDI during the past few years. In fact, acquisitions accounted for more than 80% of all FDI globally in 1999. In fact, there are a variety of factors that can make an international purchase the best choice for expansion. The majority of the time, it is expected of multinational businesses to completely integrate and adhere to international rules and regulations. In this sense, it would be advantageous for an expansion if the current management team's members and the majority of the managerial procedures remained in place. Generally speaking, many of the laborious details associated with entering a new market can be made simpler by purchasing a foreign company (UNCTAD, 1994, p. 84).

#### **2.1.10 Purposes of FDI**

The forms of FDI vary depending on the objectives of the investments. We will try to give a succinct explanation of these purposes.

##### ***2.1.10.1 Investment Pursuing Natural Resources***

Most multinational corporations strive to make profits from the natural resources and raw materials that many developing countries possess. Particularly in the domains of oil and gas and numerous other extractive industries. This kind promotes increased imports of capital goods, consumables, and intermediate production inputs while increasing exports of raw materials (Hamid, 2000, P. 3).

### ***2.1.10.2 Investment Pursuing Markets***

Throughout the 1960s and 1970s, while the import substitution policy was in place, this form of investment predominated in the manufacturing sectors of emerging nations. This kind is seen as a replacement for export from the exporting country for investment, and it is present in the host country as a result of import limitations. In addition, there are other factors that make this form of investment more viable than exporting to the host country, such as the high cost of shipping there. As exports are being replaced, in this instance, this form of investment has no impact on production. Instead, it has a favorable impact on consumption and an indirect favorable impact on commerce. type of investment would support the high growth rates in the country hosting the investment, by boosting the country's capital balance and expanding both the host country's exports and its imports of goods and production inputs from other countries. It would also have expansionary effects on trade in the production and consumption sectors. This kind of investment has taken on various shapes, such as when multinational corporations shift a portion of their labor-intensive production processes to the host country to be executed by national enterprises in accordance with a bilateral agreement. By doing this, the company in the host country can access global markets that would otherwise be inaccessible to it because it lacks the information, channels, and distribution networks that are available to multinational corporations. The idea of moving labor-intensive activities into developing countries during the past few years has contributed to the increase in industrial exports to those countries (Hamid, 2000, P. 3-4).

### ***2.1.10.3 Investment Pursuing efficiency in performance***

Multinational corporations make this kind of investment when they concentrate a portion of their operations in the host economies in an effort to boost profitability. Some of these businesses made investments in numerous developing countries as a result of the high wages in developed countries. This kind of investment is distinguished by its expansionary impacts on the trade of the host country, which results in the diversification of its exports as well as its expansionary effects on consumption by importing numerous production inputs. This kind of investment has taken on various shapes, such as when multinational corporations shift a portion of their labor-intensive production processes to the host country to be executed out by national enterprises in accordance with a bilateral agreement. By doing this, the company in the host country can access global markets that

would otherwise be inaccessible to it because it lacks the information, channels, and distribution networks that are available to multinational corporations. The idea of moving labor-intensive activities to developing countries during the past few years has contributed to the increase in industrial exports to those countries. Another example of this type is the manufacturing of some components abroad because of the high wages or high currency exchange rate in the mother country. However, because the country receiving the investment must have high productivity and technical proficiency, this process is currently focused on a small number of newly industrialized nations. When a local business creates a product under a subcontract with a larger business, branding it with the parent business's trademark for marketing purposes. This activity might improve the company's manufacturing capacity in the country receiving the investment, encouraging it to make the good on its own and for its own needs before entering the market, which is thought of as an improvement in quality. One of the most crucial aspects of this form of investment is that because it is connected to the parent firm in the target country, the exports of this commodity to the industrial country are not subject to trade restrictions (Hamid, 2000, P. 4-6).

#### ***2.1.10.4 Investment Pursuing Strategic Assets***

When a multinational corporation invests in the field of research and development in a developing or established country in order to increase profitability, this type of investment occurs in the latter stages of the company's operations. The developing countries view it as an export of trained workers, and it boosts the exports of services and equipment from the country exporting the investment (Hamid, 2000, P. 9-11). Foreign direct investment, in terms of the nature of the investing entity, can also have several forms, the most important ones as follow:

1. private investment which is private FDI primarily made in sectors with a lower level of risk, the most significant of which are primary product sectors in developing countries, particularly in the oil sector. It is an investment made by the private sector or by individuals in any country or anywhere in the world outside their country.
2. Bilateral investment, this type of FDI emerged as a result of the national tendency and independence movements that predominated in developing countries after they gained

their independence, and it is stated that this form of investment lessens the financial burdens carried by the countries involved. Bilateral investment is defined as the participation of developing countries with foreign investors in economic projects established on their territory.

3. FDI in the form of multinational companies, according to indicators, multinational corporations are responsible for more than 80% of the total amount of foreign direct investments made in the world. They have also occupied most industries that require advanced technology, including the production and processing of raw and agricultural materials, industrial machinery, and computers, as well as the services sector, which includes fast food, soft drinks, insurance, and banking. Multinational corporations are renowned for the variety and scale of their investment activities, which enable them to set up numerous branches in different nations throughout the world, whether developed or developing.

#### **2.1.11 Advantages and Disadvantages of FDI**

Foreign direct investment, particularly through multinational corporations, is one of the mechanisms of economic globalization and has both advantages and disadvantages for developing countries. The following explanation provides the key advantages (Hanna, 2002, P. 14-23).

- It results in an increase in the gross domestic product in the host country and an improvement in the quality of the products, particularly in the case of joint economic projects as subsidiaries of multinational companies with developing country companies, this causes the opening of international markets for those products, which in turn leads to a rise in economic growth rates, an increase in average per capita income, and an improvement in the standard of living. In addition, it causes the growth of high-productivity economic sectors and corrects structural economic imbalances. Therefore, this investment supports domestic investment through the impact of industrial ties by purchasing local goods and providing them with intermediate inputs.

- It results in the development of the economic infrastructure associated with the geographic area of this investment, including roads, bridges, buildings, transportation infrastructure, communications, and services in the fields of education and health, which form the core pillars of economic development.
- This investment is deemed the provider of hard foreign currencies through products of these investment projects meant for export characterized by their competitiveness in the global markets. This positively affects the trade balance of the country hosting the investment, as well as its balance of payments.
- It results in resolving the issue of unemployment facing developing countries and offering job opportunities for the domestic labor force.
- It results in the advancement of scientific and technological knowledge in the host country. This advancement is made possible by offering a bundle of production methods, marketing strategies, and technical knowledge, particularly if the technology is targeted toward transformational industries. Keeping technology under the control of multinational corporations and their countries, rather than on the basis of the interests of developing countries, is a complicated issue that must be addressed.
- This investment leads to the acquisition of skills, management experience, and organizational capabilities in the developing country.
- It leads to the transfer of the expertise of developed banks in the countries related to this investment to the banks of the host countries.

With regard to the disadvantages that may result from FDI in a developing country, the core (economic and non-economic) disadvantages can be stated as follow: (Mohammed Taka, 2008, P. 24-34)

- **Economic Disadvantages**

- Regarding the profits made by FDI mechanisms, this investment's primary goal could cause it to shift toward non-basic economic projects for the developing country, like food consumption projects.
- Financial and economic difficulties in the developing country hosting the investment could result from the exit of these earnings as well as capital withdrawals. An excellent example of this is what occurred in the Asian Tiger countries in the late 20th century following the quick withdrawal of foreign money from them. This indicates that the developing country is the loser.
- The use of capital-intensive production by foreign investment firms, particularly in a developing country with a high population density, neither solves unemployment nor results in the availability of job opportunities and may even cause a spike in unemployment.
- FDI in non-core economic activities could cause basic economic activity to be replaced.
- This investment places burdens on the economy of the developing country, such as the transfer of profits and a portion of the salaries of foreign employees, which puts a strain on the country's balance of payments and foreign exchange reserves.
- If the amount of capital invested in the hosting country is significant compared to the volume of wealth in that country, it could result in the control of foreigners over a portion of that country's wealth and the exercise of economic influence in coordination with the social and political groups that stand to gain from the investment.
- Such investments might discourage people and businesses in developing countries from raising their savings.

- **Non-economic Disadvantages**

- Technological disadvantage, which is the transfer of a particular type of technology that is incompatible with the features of a host country by FDI companies, because the technology used is in line with the business strategy of those companies rather than the needs of the host country.
- Political disadvantages, which emerge as a reduction in sovereignty and a potential influence on political decisions, occur when FDI is substantial relative to the level of wealth in a developing country. The best example of this is the foreign investment firms in the oil industry.
- Social disadvantage, which results from this investment may also result in the formation of social groups with shared interests with the main foreign corporations or may result in a social consumption pattern that converges with the social environment of the developing country.

#### **2.1.12 Fundamentals of FDI**

Three fundamental components are required for effective investing, and they are as follows (Kamel Faleh, 2014, P. 12-23):

- ***Reliance on an appropriate strategy:*** The optimal strategy mostly depends on the investor's priorities, which are shown or reflected by his investment preference curve, which is created by the investor's needs for security, liquidity, and profitability.
- ***To Be guided by the scientific foundations for decision-making:*** The investor must use the scientific method when making decisions to be rational. This includes defining the investment goal, gathering the necessary data and information, analyzing, and studying the financial aspects of investment alternatives, and selecting the best investment alternative.
- ***Observance of the relationship between return and risk:*** The investor must anticipate both the expected return and the level of risk before deciding. To do this, they must forecast both the return and the level of return realization. The level of risk is then determined in light of the estimated level of return achieved because the level of risk is determined by the failure to achieve the expected return.

### 2.1.13 Forms of FDI

FDI involves several forms which can be stated as follows:

- ***Joint investment:*** It is also known as bilateral investment and it is a foreign investment based on participation with the national capital, whether this participation is in varying proportions depending on the situation and as allowed by national legislation in this regard, or equal proportions between the national or foreign capital, where its ownership can be divided between one or more foreign parties on one hand, and one or more national parties on the other hand (Khayali, 2012, P. 7).
- ***Investment wholly owned by the foreign investor:*** It is the most preferred form, due to the complete freedom enjoyed by these companies in the will and supervision of these projects, as well as the expectation of achieving high profits through this investment, as well as the possibility of overcoming trade and customs restrictions imposed by the host countries on imports (Saad Mahmood, 2007, P. 3).
- ***Investment in free zones:*** Investments in free zones aim to develop exports and integrate into the international economy. Investments made in free zones are subject to a highly supportive system, as they benefit from several privileges not found in other zones. These investments are in export-oriented activities, and the commercial relations between the enterprises located in the free zone and the enterprises located across the national territory are considered foreign trade operations, where the investment here is far from being subject to the laws of the host country and operates through the laws regulating it. These investments are exempted from all taxes, fees, and deductions. Of a fiscal, semi-financial, and customs nature, and its goal is usually to produce goods destined for export (Mergad, 2000-2003, P. 10).
- ***Mergers and acquisitions:*** They are referred to as companies merging or purchasing other companies in what is known as the holding or subsidiary company. These operations have increased in the recent period and become a major source of FDI (Poid, 2010-2011, P. 38).

#### **2.1.14 The Motives of FDI (Host Country Perspective)**

Most countries, especially developing countries, seek to attract FDI to achieve a set of goals that they deem appropriate and serve their economic conditions. To explain the motivation for direct foreign investment we intend to present the model of Dunning (eclectic paradigm). The theory of "eclectic" is the most comprehensive approach to FDI, especially internalization theory, performed and perfected gradually over more than 50 years of studies and work by John H. Dunning. The theory focuses on an eclectic paradigm, namely a new concept that is a mixture of previous concepts, and fragmented thinking, not original ideas that take only significant ideas from different theories or approaches and synthesize them. According to this theory, FDI is motivated by three advantages: Ownership advantages; Location advantages; Internalization advantages (Hanson, Gordon H, 2001, P. 535).

##### ***2.1.14.1 Addressing the Resource Gap***

Economic growth depends mainly on new investments and how efficiently they are distributed, and these investments depend on the volume of savings. If the state suffers from a deficit in those savings, it will resort to foreign direct investments (Viorela, B. 2009, P. 24).

##### ***2.1.14.2 Fulfilling Capacity Limitation***

Developing countries resort to foreign investments, as they suffer from a low expected return from the invested capital due to the high cost of importing technical equipment. However, if such equipment and machines are provided by the foreign investor, their costs will be lower than those imported by the local investor, and the expected rate of return for the foreign investor will exceed the rate of return expected by the local investor (Journal of International Economics, 2004, P. 62).

##### ***2.1.14.3 Transfer of Modern and Advanced Technology***

Foreign investment does not mean merely providing foreign currencies that contribute to financing only, but rather machines and equipment on the finest technical methods and the latest technology, as the World Investment Report for the year 2015 indicates that the field of the machinery industry, for example, contributed when it entered the markets of

developing countries in reducing the obstacle of developed countries. Likewise, economically, developing countries cannot pay the cost of imports of imported productive goods and services. In such a case, it is necessary to resort to external financing and attract foreign investment to increase exports and reduce imports of consumer goods (Imam, M. 2013, P. 119).

#### ***2.1.14.4 Employment Opportunity Creation***

Developing countries experience shortcomings in using the full human potential, as there are high rates of compulsory and persuasive unemployment, and most of the ways to address such a dilemma are with measures to create jobs in the public sector, and this is not a serious treatment. In the case of foreign investments, they create job opportunities for those who are unemployed. In addition, their work will contribute to increasing education. This provides important real jobs in the national economy that contribute to improving management knowledge and skills and boosting productivity (Marwan, 2008, P. 6).

#### ***2.1.14.5 Monetary Capital Increase***

Foreign investment can have positive impacts that stimulate growth and the local capital supply. It can also have positive effects that increase production and efficiency through competition and experience. The majority of foreign investments aim for trade efficiency as final or intermediate goods, while some want to test out resources.

#### ***2.1.14.6 Export Diversification***

Most developing countries depend on raw materials for their exports, especially oil countries, and their prices are subject to fluctuations, meaning that the economies are one-sided. As for foreign direct investment, it contributes to the creation of various industries, such as the manufacture of commodities that depend on oil derivatives, as well as commodities that depend on cotton as a raw material. Establishing factories to produce clothes and other textiles instead of exporting cotton and wool as raw materials. This contributes to increasing national income, addressing imbalances in the balance of payments, and providing goods to consumers at low prices (Amira, 2005, P. 32).

### **2.1.15 FDI and the Law**

The aim of FDI law is to regulate rules that would promote FDI, and preserve the rights of foreign investors. The definition of investment and investor in accordance with the international standards is to set up a notification-based system for FDIs to stimulate investments through solid and established policies. The internal laws of countries varied among themselves, and the international treaties differed in their definition of investment, between agreeing on a comprehensive definition that prevents this concept or expanding the concept of investment. For instance, in order to encourage the flow of capital across international investment borders, the agreement of establishing the International Center for Settlement of Investment Disputes did not define the term "investment" or identify a mechanism for resolving disputes. All of this is due to the fact that investment is not a particular economic or legal phenomenon (Money and credit law, 1990, P.16).

#### ***2.1.15.1 FDI in International Law***

The United Nations Declaration on Considering the Right to Development as a Human Right to which Other Human Rights Are Linked places a crucial obligation on states to achieve equal opportunities for individuals to access development resources and benefit from the fruits of development. Additionally, the Declaration calls for the free and effective participation of all individuals concerned in making decisions related to it, and the practice should be transparent. However, due to the weakness of the legal systems in some countries, and their lack of effectiveness, which may impede the flow of these investments and expose them to many risks, this led the international community to search for appropriate means to protect these investments, and it can be said that the distinctive characteristics of the rules for protecting foreign investment in international law are due in a way Fundamental to the nature of the mechanisms adopted by international law in establishing, amending and abolishing these rules, and they differ radically from what prevails in the internal legal system, because the will of the individual state to amend and cancel its legislation, and its authority to take what it sees of internal measures and procedures that we find broad and unrestricted Except within certain limits imposed by the domestic legal system, while its will and authority are restricted by many international obligations that make countries responsible in the event of damage to foreign investment, even if their procedures do not constitute a violation of domestic law (Public international law. 2020).

### ***2.1.15.2 FDI in Yemeni Law***

The investment law in Yemen aims to draw, promote, and develop both local and foreign investments within the framework of official public policy, national objectives, and economic and social development priorities. The implementation of the provision of the law of FDI can be expressed as follows (UNCTAD, 2010):

- Capital: The local or foreign capital invested in the project, including:
  - a) foreign currency, local currency, and any form of liquid monetary assets.
  - b) Assets and any movable property related to the project.
  - c) Immovable property, including land and buildings.
  - d) Intellectual property rights or any other moral rights, such as licenses, patents, trademarks, and other intellectual rights registered within or outside the Republic, so long as they are safeguarded by international or national laws.
  
- Investor: Any individual or entity that owns an investment project in the Republic in compliance with existing legislation, regardless of place of residence or nationality.
  
- Investment: The use of capital by the investor in the project to obtain benefits, intellectual property rights, and other tangible or intangible benefits, including project incorporation, project continuation, or project maintenance costs.
  
- Project: The investment project being established by the investor in accordance with this law.
  
- Promotion: Presenting Yemen as a desirable location for investment while enticing investors to launch and expand investment ventures.
  
- Facilitation: Assisting the investor in using the One-Stop Shop to contact the relevant government agencies for information, services, and the required legal paperwork.

- Application Form: The form that the investor must complete which contains all relevant data and information, in order for the investment project to be registered in the Investment Registry.
- Investment Register: The General Investment Authority established the Investment Registry to serve as a repository for the data and information pertaining to investors and investment projects.
- Services Fees: The charges set by the Board of Directors for the professional and administrative assistance rendered by the General Investment Authority.

#### **2.1.16 The Volume of Foreign Investment Globally and in Yemen**

The International Investment Report 2008, issued by the United Nations Conference on Trade and Development (UNCTAD), showed that FDI reached its peak in 2007, as inbound FDI flows grew globally for the fifth consecutive year at a rate of (30%) to reach \$1833 billion, compared to roughly \$1411 billion in 2006, surpassing the record level reached in 2000 by about \$400 billion. This came despite the financial and credit crises that began in the second half of the year 2007. According to the data presented in the report, the main economic groups (developed, developing, and transitional economies) experienced continuous growth in inflows to them, with the share of developed countries amounting to approximately \$1248 billion (68%), and the countries of transition economies approximately \$85.9 billion (4.7%), while the share of Arab countries in total flows amounted to approximately \$72.1 billion, thus achieving a rate of (3.9%) of the total. According to UNCTAD estimates, FDI decreased globally as a result of the financial crisis from \$1.9 trillion in 2007 to \$1.6 trillion in 2008, and this decline persisted into the first quarter of 2009 by (44%) compared to the same period in 2008. FDI inflows reached an all-time high of \$500 billion in developing countries, up (21%) from their level in 2006, which includes the GCC countries. FDI into the least developed nations totaled \$13 billion in 2007, which is likewise seen as a good record (UNCTAD, 2010).

For Yemen, a local newspaper, reported that \$1.5 billion are the value of foreign investments that have left Yemen abroad since the Houthis took control of state institutions in 2014. A study on financing development in Yemen, issued by the Ministry

of Planning and International Cooperation and funded by UNICEF, that the flight of foreign capital abroad amounted to an average of (217) million dollars annually during the period 2014-2021. Since the coup of the Houthi group against the state, Yemen has witnessed a significant deterioration in attracting foreign investments, and the investment environment has turned into one that repels foreign and national investments. Reports indicate that the share of least developed countries in global trade and FDI is less than 1%. And that approximately 88% of FDI in Yemen was concentrated in the oil and natural gas sector during 2005-2010. In addition to the negative effects of the continuation of the Houthi militia coup, which has extended since 2014 until now, and its negative and devastating effects on the country's security and stability, and its repercussions on the general and economic environment in particular. Yemen had made great progress in attracting foreign investments, as the average volume of foreign investments entering Yemen reached \$197 million for the period 2000-2013. The highest value of foreign investment flows was achieved in 2008, with an average of \$1.5 billion, while foreign investment flows in Yemen were marked by a decline until they reached \$134 million in 2013 (Yemen Future Newspaper, 2018).

### **2.1.17 Effects of FDI on the Host Country**

It has been recognized that FDI can have a positive and negative impact on the host country, and examples of the positive impact include enhanced export market access, tax income generation, and payment balance improvement. Inflows of FDI, however, can also be detrimental. The competitiveness may suffer as a result of an MNE, and local businesses may even go out of business, another negative effect that MNE can result in is environmental degradation in the host country. This section will be limited to a discussion of the three main pillars, spillovers, effects of employment, and institutions (Johnson, A. 2005).

#### **2.1.17.1 Technology Spillover**

A positive externality of FDI that host nations aim to take advantage of is the potential for technology spillovers. According to Blomström and Kokko (2003), one of the main reasons host nation governments strive to draw FDI inflows is the potential for technology spillover. According to Markusen (1995), the theoretical framework for technology spillover through FDI is that MNEs nowadays are classified as being knowledge-

intensive in the sense that they have substantial R&D expenditure and technologically advanced products. Hymer stated that an MNE must have a firm-specific advantage in order to successfully compete in a foreign market. A common firm-specific advantage is probably more advanced technology, given how important knowledge capital is to MNEs. A positive externality results if the MNE does not internalize all of the benefits of its technology. An imperative question to ask in this regard is how advanced MNE's technology can be spilled over domestic firms (Blomström, 2001, P. 73).

Technology Spillovers may occur voluntarily or involuntarily. In backward linkages, where an MNE engages with a domestic supplier, Javorcik (2004) contends that the MNE has an interest in a spillover happening so that the supplier may provide the MNE with high-quality input. While unintentional spillovers happen when domestic companies are able to obtain knowledge about MNE technologies. According to Blomström et al. (2000), domestic enterprises can obtain this information by reverse engineering or by recruiting MNE employees. Glass and Saggi (1998) examine the relationships between innovation and imitation and the quality of technology transferred through FDI from a developed to a developing country. The model raises the intriguing potential that imitation can actually make technology transfer via FDI more alluring for businesses in the developed country in cases of significant technological gaps. The practice of imitation raises technological standards, allowing FDI to produce goods of higher quality. Technology spillovers are seen to have the ability to increase domestic enterprises' productivity and hence spur economic growth when they do occur. This purported ability of direct investments to increase productivity has sparked a significant quantity of empirical research employing micro-level data. Yet, empirical findings to date have been inconsistent. The connection between FDI and economic growth has also been examined on a macro level (Javorcik, 2004, P. 93).

#### ***2.1.17.2 Effects on Employment***

A fear among employees and labor unions that foreign investments by enterprises from the source nation could lead to the closure of production facilities and the layoff of workers there. This concern is typically motivated by the concern that home production will be moved abroad to benefit from cheaper labor costs. So, it is impossible to address

employment effects in the source country without also discussing employment effects in the host country.

A useful discussion of the effects of FDI flows on employment is provided by Ekholm (2004). Vertical FDI is likely to cause production to move from the source to the host country in order to benefit from variations in factor prices. Nonetheless, as vertical FDI seeks to reduce production costs, the MNE's competitiveness should increase. More market shares, the opportunity for expanded activities, and a rise in the need for workers are all implications of improved competitiveness. These two effects, therefore, combine to form the net overall effect on the labor demand of the host country. Since production that requires fewer skills is moved abroad, there should be greater relative demand for skilled labor in the country of origin. In the scenario of horizontal FDI, exports are being replaced by domestic production because there is a shift in production activities. In this instance, a decline in export production will have a negative impact on labor demand in the source country and a positive impact due to an increase in overall activity in the host country (Ekholm, 2004, 461).

The employment effects of foreign expansion on parent enterprises are studied by Brainard and Riker (1997). They discover that parent employment is negatively impacted by affiliate expansion from a high-wage country into other high-wage countries. Yet, due to complementing activities, moving from a high-wage to a low-wage country benefits parent employment. While Konings and Murphy (2001) find minimal evidence for movements in employment between high-wage and low-wage countries, Braconier and Ekholm (2000) observed meager proof that expansion into high-wage countries has a negative impact on Swedish parent employment (Brainard, 1997, P. 520).

The effects of FDI on employment cannot be researched independently of how FDI affects commerce. The correlation between FDI and exports determines the impact on export production in the source country. Exports and FDI can complement or substitute one another. A model demonstrating how trade and FDI can complement one another is provided by Baldwin and Ottaviano (2001). The simplest solution is to simply replace export-oriented production with domestic production in the host country. The parent MNE or other businesses in the source country could experience an increase in demand

for their products as a result of foreign production. So, it is feasible that these exports will lead to greater productivity in the country of source, which would suggest favorable effects on employment. These effects might not always emerge in the same sector of business. So, the overall impact of FDI outflows on the labor market of the source country depends on whether FDI and exports (commerce) are complementary or substitutive (Baldwin, 2001, P. 107).

Empirical research has been conducted to precisely pinpoint the connection between FDI and commerce. Early research, including Horst (1972), found that FDI may replace trade. Nonetheless, the weight of the evidence now points to a cooperative relationship. FDI inflows may also have an impact on wages in the host country. Do MNEs pay more than domestic companies in wages? MNEs are frequently accused of abusing workers in emerging markets. Yet, actual research shows that foreign-owned companies pay higher wages than domestic companies, see for instance Blomström (1983). Conversely, there is less evidence that FDI activity has a favorable impact on average pay levels (Lipsey, 2002, P. 111).

### ***2.1.17.3 Inflows of FDI and Host Country Institutions***

The purpose of institutions, according to North (1990), is to lower transaction costs. This is carried out by imposing restrictions on economic agents' actions to prevent opportunistic behavior. What connects institutions to foreign direct investment? The readiness of foreign businesses to establish operations in a country is influenced by the caliber of its institutions. Previous studies have demonstrated how weak host country institutions do in fact tend to reduce FDI inflows. Recently, institutional perspective research has become interested in examining the connection between FDI and the presence of corruption in host countries. This section employs the concept of bureaucratic corruption to explain how corrupt behavior on the part of public officials drives up the cost of MNE operations. The research makes the case that weak market economy institutions are to blame for the existence of bureaucratic corruption in many developing economies (North, 2007, P. 44).

Wei (2000) and others conducted empirical research where they revealed that host countries' corruption decreases FDI inflow. From an MNE's point of view, the issue with

host country corruption is that it drives up the expenses related to running a company. Thus, corruption tends to discourage MNEs from investing and reduce FDI inflows. According to the results of the study in this part, corruption lowers FDI inflows to emerging economies (Wei, 1990, P. 304).

Is it feasible for an MNE carrying out FDI in a host country to have an impact on corruption? According to North (1990), organizations in the shape of firms or political parties have an impact on institutions. A negotiation situation arises between an MNE and the government of the host country when the MNE considers investing there. MNEs may therefore influence host country institutions through the drafting of investment agreements. To lessen the severity of corruption, the MNE could call for a change in the legal system. Another possibility is that there is a legal structure in existence, but it is not being enforced (North, 2001, P. 303).

How could an MNE influence institutions once it has entered the host country? If an MNE increases its production operations in the host country, it will attain an increasing influence on the economy. So, it's possible that the MNE will become less willing to tolerate corruption. MNE interactions with local businesses may have an impact on their behavior and cause them to reconsider their current business practices (Ades and Di Tella, 1999, P. 32).

### 2.1.18 Trends in FDI

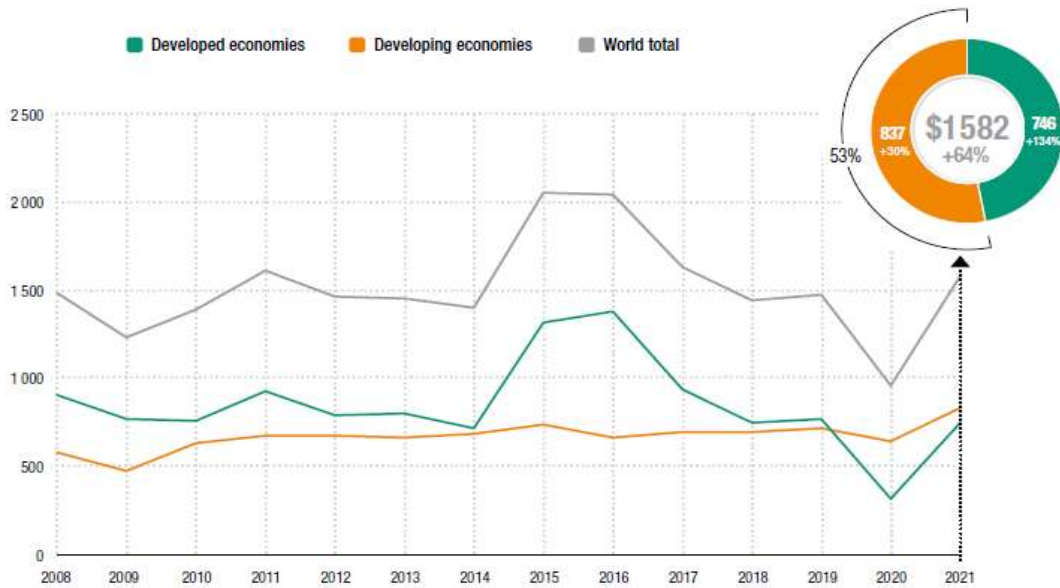
In the middle or latter part of the nineteenth century, the first signs of what would later come to be known as FDI began to emerge. According to Wilkins (1988), the first period of contemporary multinational enterprises was between 1870 and 1914. Although British portfolio investments in the form of financial capital flows continued to rule, foreign production and MNEs were firmly entrenched as components of the world economy by 1914. Cadbury, Nestlé, and Unilever were a few of the MNEs in operation at the time. Although the USA, France, and Germany were also significant direct investors, the United Kingdom was by far the most significant source country of FDI, accounting for almost 45 percent of the global stock in 1914 (Dunning, 1983).



**Figure 2.3** FDI increase percentage in 2021.

Source: UNCTAD.org

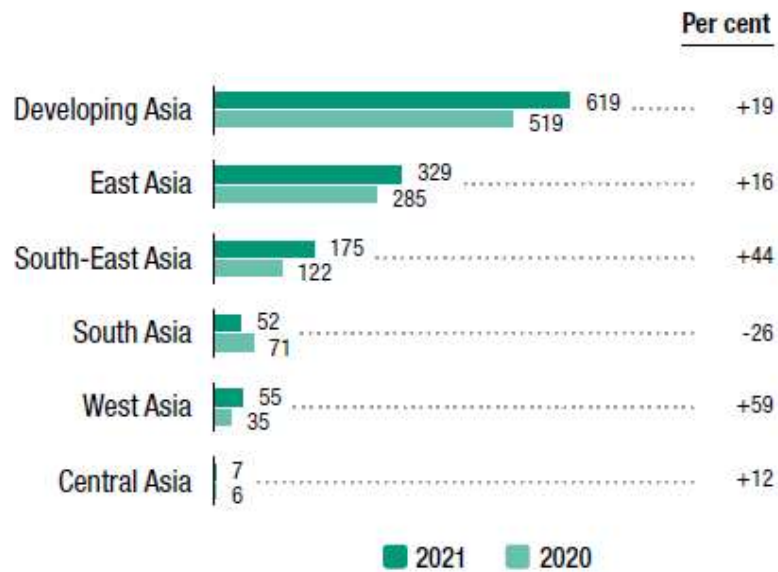
Figure 2.2 shows the percentage of FDI over the year 2021 and make-up of FDI that have evolved significantly in 2021, and this has implications for how FDI influences development, not least because countries that get more of the appropriate kind of FDI will have a greater chance of prospering. FDI has increased significantly over the previous two decades, with industrialized countries experiencing a reduction more recently, albeit there are disparities between countries (UNCTAD Economic Trends, 2022).



**Figure 2.4** FDI inflows, globally (2008-2021)

Source: UNCTAD,2022

In 2021, FDI inflows were \$1.58 trillion globally, an increase of 64% from the year 2020 when FDI inflows recorded \$1 trillion. Due to growing merger and acquisition (M & A) markets, rapid expansion in international project finance, lenient financing conditions, and significant infrastructure stimulus packages, FDI flows are gaining significantly. As shown in Figure 2.3, developing economies obtained a higher proportion of FDI inflows than developed economies globally. However, in 2022, when the globe was still suffering from the effects of the pandemic, the conflict in Ukraine broke out, drastically altering the global environment for international trade and cross-border investment. The war is having an impact well beyond its local area, resulting in a triple crisis of food, fuel, and finance, with rising energy and basic commodity prices fueling inflation and escalating debt spirals. Global FDI in 2022 may see severe downward pressure due to investor uncertainty and risk-averse conditions (UNCTAD, 2022).



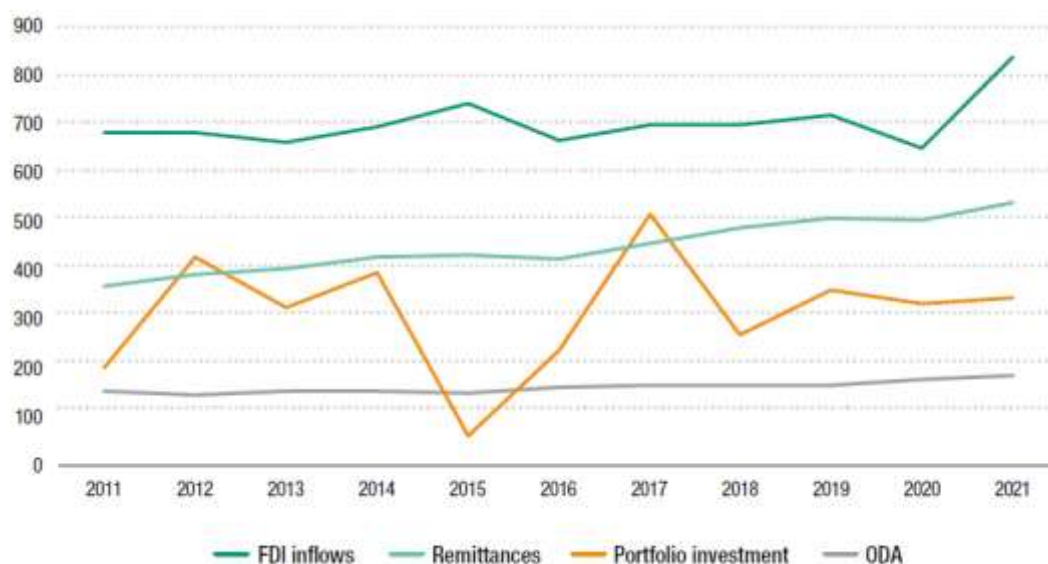
**Figure 2.5** FDI inflows in developing Asia by subregion, 2020–2021 (Billions of dollars)

Source: UNCTAD, 2022

FDI in developing Asia increased for the third year in a row to an all-time high of \$619 billion, despite multiple COVID-19 waves, demonstrating the region's resiliency. It receives 40% of all FDI inflows worldwide, making it the largest receiving region in the world. The region as a whole was sharing an upward trend in 2021, With South Asia being the sole exception. Inflows are still extremely concentrated. However, more than 80% of FDI into the region was channeled through six economies (China, Hong Kong (China), Singapore, India, the United Arab Emirates, and Indonesia) (UNCTAD, 2022).

FDI in West Asia surged by 59% from \$35 billion in 2020 to \$55 billion in 2021, mostly due to a sharp increase in cross-border M&As. While the United Arab Emirates continued to be the top receiver with stable flows of \$20 billion, inflows to Saudi Arabia tripled, and flows increased by 60% in Türkiye. DHL Global Forwarding (Germany) and Total (France) announced plans to invest \$633 million in the construction of a solar energy facility in Dubai in the United Arab Emirates. Additionally, FDI inflows to Saudi Arabia increased from \$5.3 billion in 2020 to \$19 billion in 2019, due to two significant acquisitions. Also, FDI inflows to Türkiye totaled \$13 billion, with an increase in new

equity investments. Deals in Türkiye included Socar (Azerbaijan) refinancing project debt on a number of oil and gas properties in Türkiye for \$1.3 billion (UNCTAD, 2022).



**Figure 2.6** Developing economies: sources of external finance, 2011–2021 (Billions of dollars)

Source: UNCTAD,2022

In 2021, FDI inflows to developing economies reached an all-time high of \$837 billion, up 30% from the previous year. The gain was primarily driven by Asia's robust economic performance, Latin America and the Caribbean's partial recovery, and an improvement in Africa. Just over 50% of global flows continued to flow into developing economies. Together with other cross-border capital flows, which also increased in 2021, FDI flows continue to be an essential source of external financing for developing economies (UNCTAD, 2022).

In 2022, the conflict in Ukraine and its broader repercussions, as well as macroeconomic issues such as rising interest rates, had a significant impact on FDI flows to developing economies. The effects of increasing energy prices on local consumption, and high food prices, all together caused political instability, and tighter financial conditions, which are the key factors contributing to a decline in FDI in 2022. There will be a severe reduction in fiscal headroom in many countries, particularly in developing

economies that import food and oil. Downgrades in country risk ratings and growing uncertainty among investors will be significant FDI determinants. For resource-based economies in Africa and Latin America, higher commodity prices might result in some offsetting gains in investment. Cross-border M&A sales in developing nations increased by 13% to \$42 billion in the first six months of 2022, mirroring trends in developed economies, with 40% of deals focusing on the extractive industries (UNCTAD, 2022).

## **2.2 Economic Development**

### **2.2.1 Introduction**

After World War II, economic development first rose to prominence as a key issue. When European colonialism came to an end, many former colonies and other nations with low living standards began to be referred to as "underdeveloped countries" to distinguish their economies from those of the developed nations, which were perceived to be Canada, the United States, western Europe's most populous countries, the majority of eastern European nations, the former Soviet Union, Japan, South Africa, Australia, and New Zealand. The following decades saw an increase in living standards in the majority of developing nations, then they were given the new designation of developing nations (Krueger, 2022, P. 112).

There is no agreed-upon definition of what characterizes a developing nation or what the economic development process entails. Economic development is typically assumed to occur as per capita incomes rise, and developing countries are typically characterized by this criterion. The best accessible indicator of the value of the goods and services available, per capita, each year is a country's per capita income, which is essentially synonymous with per capita output. Both indicators are the finest ones available to estimate the level of economic well-being inside a country and its economic growth, even though measuring per capita income and its rate of growth has several flaws (Myint, 2022, P. 88).

One of the most crucial fundamental conditions for the success of efforts made to realize the objectives of economic development is the availability of financing. Growth is dependent on the availability of modern production technologies and economic resources, including the capital resource represented by the country's balance of machinery, equipment, factories, buildings, roads, dams, and other components, all of which require financing for actual investment in fixed capital. Development is therefore essential to economic takeoff (Stiglitz, J.&Charton, 2005, P. 82).

The majority of developing nations after gaining independence in the 1960s of the previous century, relied on external sources such as loans, grants, aid, and FDI to finance their development during a time when they were plagued by poverty and a lack of

domestic savings. The bulk of these nations struggled to pay off their loans, therefore they accrued debt that in some cases reached 213% of their gross domestic product, as in the case of Mauritania. Around 69% of Algeria's entire export value benefited from external funding, compared to 33% for Somalia, Nigeria, Morocco, Indonesia, and Türkiye. Most importantly, Muslim nations have been drawn into the trap of usurious financing transactions, and it has become difficult for them to break free until the majority of impoverished nations have pleaded with Western nations and organizations to exempt them from the debts, which can only be done at the expense of their political freedom (El-Karanshawy, 1995, P. 302).

### **2.2.2 The Concept of Economic Development**

Economic growth and development are two ideas that economists distinguish from one another. A gain in the percentage of public production measured at constant prices or the actual increase in national income is referred to as economic growth. A nation whose economy depends on the production and export of commodities like oil, gas, coal, coffee, and iron can experience economic growth by increasing the pricing of these goods on the international markets. Economic development shouldn't be interpreted as a complete, superficial, temporary, or transient change that is only present in the development's constituent elements. Instead, it is a complicated, intertwined aim that strives to fundamentally alter the economic structure and raises productivity in proportion to the effective utilization of available resources on a national and global scale as well as the technology level. There is no doubt how arduous and drawn out this process is. Bringing about such a shift is not simple. The economic structures show resistance to change, with resistance increasing with backward economies and vice versa. Since continuing economic development is an issue for both rich and poor countries, it is important to note that the term "economic development" is also related to the long term. As a result, the increase in the national product must be constant and uninterrupted for a long time. The long-term should last at least 15 years. But, for developing nations, accelerated development is crucial (Abokuhf, 2001, P. 116).

The study of economic development is one of the relatively recent studies that the science of economics focused on after the beginning of the twentieth century, particularly in developing countries. In general, economic development can be defined as a process

in which the real income is increased cumulatively, rapidly, and continuously over time so that this increase is greater than the rate of population growth with the provision of productive and social services and the protection of renewable resources from pollution and the preservation of non-renewable resources from depletion. In addition to achieving continuous growth and sustainable development over time, there are other different conceptions of the process of economic development, including those that claim it is interested in the efficient allocation of currently scarce or idle productive resources. It also must deal with institutional, political, social, and economic mechanisms and tools in the presence of both the public and private sectors because doing so will help actualize and accomplish rapid and continual improvement in living standards (Albili, 2009, P.139).

### **2.2.3 Importance of Economic Development**

The importance of economic development is a way to gradually minimize the economic and technical gap between developing and developed countries, even though there are economic and non-economic factors that contributed to widening the gap, which is still deeply ingrained and parallel in the economic structures. This type of development is highly dependent on a well-thought-out vision and strategy. Similar to how development in developing countries was restricted to the traditional notions of development represented by the growth rate of national income and raising the average per capita income, without consideration for how this growth is produced or the status of income distribution among population groups (World Bank, 1991).

- Economic development is the most crucial tool for assisting countries in achieving economic independence and avoiding economic dependence and dependency in its various forms. As a result of progress and economic growth that enables a country to be free of this dependence in all of its forms.
- Economic development strives to raise the standard of living of society's individuals by raising their earnings and giving them job opportunities, which is reflected in their levels of health and education.

- Economic development aims to provide society's members with the right kind and amount of goods and services. It also aims to close the social class gap to maintain social and political stability.
- Economic development works, at the macroeconomic level, to improve the domestic product and achieve the desired economic development. It also works to reduce the social gap between developed and developing countries.

#### **2.2.4 Goals of Economic Development**

In the field of studying the goals of economic development, it may be challenging to define, in a standard manner, goals for economic development that can be consistently applied to all countries of the world due to the great variation in the economic, political, social, and cultural conditions of each country. Before we discuss these major objectives, it is important to highlight that when establishing objectives for economic development, the following factors must be taken into consideration:

- These conditions should help assess and gauge the extent of progress achieved by economic development programs.
- These objectives must determine the required level of human, technical, administrative, and other energies to achieve the objectives of economic development.
- Objectives must be set in a way that defines the highest priority requirements of the economic development process so that these requirements are implemented without others.
- Objectives must be formulated in a way that works to exploit all elements of a production as much as possible through the production process.

#### ***2.2.4.1 Increase in National Income***

The primary motivation for the country to pursue economic development is a decline in the standard of living and poverty, as well as an increase in the growth of its population. As a result, increasing the national income is seen as one of the initial objectives of economic development. The only way to eliminate poverty, improve living standards, and address the population problem is to raise real national income. This is done by making it possible for people to meet their fundamental needs by purchasing the commodities and services provided by different economic resources over a specific period (Subramanian and A. Trebbi, 2002, P. 73).

The increase in the real national income in any country is governed by certain factors such as the increase in population and the country's material and technical capabilities, The more funds are available and the better the qualifications, the higher the real national income can be achieved. Conversely, the rarer these factors are, the percentage of what can be achieved in real national income is usually relatively small (UNCTAD, 2000).

Likewise, the greater the rate of population increase, the more countries are forced to work to achieve a higher increase in their real national income, but the limits of this increase depend on the material and technical capabilities of the countries. In general, it can be said that increasing the real national income, whatever the size or type of this increase, is considered one of the first goals of economic development at all in economically developing countries (UNCTAD, 2000).

#### ***2.2.4.2 Improvement of Standard of Living***

Since a high standard of living for the population is one of the essentials of existence, along with food, clothing, and housing, it is one of the main goals that developing countries attempt to achieve. A country's population's standard of living can be raised through economic development in addition to raising the annual national revenue. In some countries, it is noted that a small portion of the population controls the majority of the nation's financial resources and economic activity, which suggests that income is not distributed fairly among the social classes in most developed countries (Crafts, N. and Toniolo, G, 1996, P. 22).

Similarly, there is a close correlation between income and population. Whenever the population grows faster than the income grows, the amount of per capita income declines, thus leading to a lower standard of living. The fulfillment of a person's cultural and societal demands is one indicator of the standard of life, together with how many goods and services they consume ((Crafts, N. and Toniolo, G, 1996, P. 23).

#### ***2.2.4.3 Reducing Inequality in the Distribution of Income and Wealth***

One of the societal objectives of the economic development process is to lessen income inequality. Most emerging economies that have low national incomes and average per capita shares also have unequal distributions of wealth and income. A tiny percentage of the population may obtain a significant portion of the revenue. Wealth, yet the majority of people suffer from poverty, deprivation, and low income, which results in a low standard of living, poor health, and poor education (Valerie J. Carter, 2022, Web-Published).

Certainly, the unequal distribution of income has negative effects that are reflected in the majority's lack of a sense of social justice. This unequal distribution causes people to be classified, which wastes resources. The state will import commodities from industrialized countries since the wealthy will spend their money on luxury items, resulting in a balance of payments deficit and other economic issues (Valerie J. Carter, 2022, Web-Published).

#### ***2.2.4.4 Adjusting the Relative Composition of the National Economy***

This objective centers on altering the national economy's traditional characteristics and relative composition. The agricultural sector dominates the economic structure of developing countries in terms of production and provides a living for the great majority of the population. In terms of other industries, it also plays the most significant role as a generator of national income and Its control over the economies of developing countries poses a serious threat to it as a result of economic fluctuations in production and prices. For instance, if the agricultural crop was abundant or the international market prices increased, this would result in a wave of boom and prosperity. On the other hand, if the crop was in short supply or the world prices dropped, this would result in a recession and increased unemployment in the nation (Wiley, 2000, P. 425).

Therefore, economic development must seek to reduce the control of agriculture over the national economy, and allow the industry to play its role, along with the rest of the other sectors of the national economy, and thus ensure the elimination of the fluctuations that affect national activity as a result of agricultural control over it, or at least ensure the reduction of its severity. Allocating a significant proportion of the country's resources allocated for economic development to the advancement of the industry, whether by establishing new industries or expanding existing industries, in order to ensure the elimination of the numerous problems raised by the dominance of agriculture in the economic structure (Wiley, 2000, P. 431).

From the foregoing, we find that defining these and other goals that are set to achieve economic development requires knowing the productive elements available in countries and determining the availability of these elements for exploitation so that development plans are not in a situation that is not in line with the availability of production factors, such as ambitious development plans. The productive elements available in countries are not sufficient to implement them. That is, the development programs must be possible to implement through the available resources, and what can be provided from these resources. In addition to the importance of matching resources with development plans, the goals of development plans in the economic sectors do not conflict with each other, because conflicting goals hinder development plans from reaching comprehensive and sustainable economic development.

### **2.2.5 Elements of Economic Development**

Economists have been accustomed to studying economic development as the necessary economic need for developing societies, and as not only increasing the productive capacity quantitatively but rather means a structural change in the developing economy, meaning a change in the relative importance of economic sectors and activities that leads to a rise in the real national income of the country over time. certain development of the population's standard of living. The process of economic development relies on basic elements represented in human resources, natural resources, capital formation, and technological progress, as prerequisites for this process. when embarking on any growth or development process, whether short-term or long-term, certain elements

need to be taken into account. These elements will always accompany the planners and implementers of the development process (Bertan, 1982, P. 53-62).

- 1- **Employment:** Two prerequisites for labor to be able to deal with contemporary methods and means of production are efficiency and expertise. In other words, the vast majority of people who lack the necessary skills to operate a sophisticated computer or modern machine could be a barrier to economic development. This is evident in many nations with high unemployment rates that hire talented foreign employees across all industries, but especially in the manufacturing and service sectors, as well as those with credentials like university professors, bank managers, and doctors.
- 2- **Capital:** Here, proper methods of production are intended, along with the conditions that must be met in order to take advantage of them. The level of saving, which is the difference between income and spending, determines the supply of capital. People in developing nations lack capital because they spend the majority of their income on consumption.
- 3- **Natural Resources:** This element is considered to be useful because certain countries, like Japan, lack natural resources but are nonetheless economically dominant, whereas the majority of Arab nations have abundant natural resources but are still in the process of developing. the possession of arable land, minerals, and wealth that the land has in terms of its abundance and diversity, investing in it economically and efficiently transforms it into a tool for the achievement of development. This can be accomplished through foreign direct investment.
- 4- **Human Capital:** The most important and efficient part of economic development is the development of these resources. Raising awareness and bolstering the process of family planning and birth control in developing countries facing the issue of population explosion is a crucial issue required by the development process along with the qualitative aspect, such as improving health status, eradicating illiteracy, advancing education, preparing workers, and improving nutritional status, which results in higher productivity because it increases their ability to use capital more efficiently and effectively.

5- **Technology:** By definition, technology is the ability to transform raw materials into goods and services. In this context, technology plays a more significant role than when it is used to create new types of goods or improve on already existing ones. To put it another way, each component of production, including land, labor, and capital, requires a wide range of technologies to generate a wide range of commodities and services. Obtaining the arts of science and technology leads to the development of human resources and the adaptation of natural resources to serve the process of economic development. This can be accomplished through foreign direct investment. The majority of economists view this as the most essential element in economic development, which is lacking in developing countries. According to the foregoing, FDI conveys administrative, organizational, and technological knowledge to the host country while also assisting in the development of the fundamental components of economic development, particularly human and natural resources (Moran, T. H. 1998, P. 119).

The world can be classified economically in terms of the level of development reached by countries into three categories:

- First world: Refers to countries that enjoy great industrial and technological development and that have been able to provide a high standard of living for a large part of their citizens and to be recognized globally. The United States, Japan, Germany, France, the United Kingdom, Spain, Italy, and Canada are the most important countries that make up this world.
- Second world: Refers to the group of countries that went through the socialist experiment, opposing the intellectual system of the first world. The countries of the Second World were distinguished from the countries of the First World by their rejection of the culture of liberalism and open capitalism. They are also distinguished from the Third World by their level of education, the size of their countries, and their relative strength.
- Third world: The expression was used for the first time in 1952 in an article issued by the French economist and demographer "Alfred Sauvy" in reference to countries that

do not belong to the group of "Western countries" (North America, Western Europe, Australia...) nor the communist group (the Soviet Union, China, and Eastern Europe). Sauvy was inspired by this designation from the third class in French society during the old regime and before the French Revolution.

## **2.2.6 Theories of Economic Development**

Economic development theories attempt to research and explain the phenomena related to economic development, in terms of the causes, obstacles, and concepts related to these phenomena in order to build a structure of knowledge that can be relied upon in bringing about economic development, or at least the advancement of societies that suffer from the lack of development or its weakness, so that The process of economic development cannot take place randomly, but must be based on a specific strategy built on a specific theoretical basis.

### **2.2.6.1 Linear Stages Theories**

The scientist Rostow developed these theories in 1950 AD, he published them in the book *Stages of Economic Development* in 1960 AD. Marx's theory of the stages of economic development served as the foundation for Rostow's theory, which emphasizes the significance of capital formation through saving for economic investment to spur economic growth and achieve the necessary economic development. Rostow's theory states that economic development includes a series of five successive stages that any country must pass through during its economic development. These stages are: (Cairncross, A. K. 1961, P. 450-458)

- **Traditional society stage:** It is a stage that depicts the condition of ancient societies with a hierarchy of class, in terms of productivity, education, migration, and social change, the majority of whom are engaged in agricultural work.
  
- **Preconditions for take-off stage:** It is a transitional stage that includes securing a specific level of investment, up to 10% of the national revenue, by expanding investments in the economic infrastructure, particularly in the sector of education. At this stage, agricultural output is defined by the use of modern tools. This stage also

seeks to integrate the agricultural industry with other economic sectors, which results in a progressive shift of employment from the agricultural industry to these sectors.

- **Take-off stage:** It is a stage that signifies the control of barriers from earlier stages that impeded progress and economic development. It is also a stage that encourages investment that exceeds 10% of the national income and reaches 20%, which raises the average person's income. In this stage, pioneering economic sectors emerge that lead the development process.
- **Drive to maturity:** In this stage, society uses modern technology to take advantage of its economic resources, and at this stage, the desired economic growth of society is achieved due to structural changes.
- **Age of high mass consumption:** It is represented by changing the focus on economic activities from the center to the periphery, as it is represented by a high consumption pattern by members of society.

#### **2.2.6.2 Structural Change Theories**

These theories deal with policies that aim to transform the economies of developing countries from being economies that rely mostly on agriculture for subsistence to economies that are more developed and expanding and rely on a variety of industries and services. There are two models for this theory: (Lin, Y, J. 2009, P.1-14)

- Arthur Lewis model: It is regarded as one of the most significant contemporary theories of development in developing countries and is predicated on the idea that there is an unlimited supply of labor. It also states that shifting a certain proportion of labor from one economic sector to another influences productivity and leads to growth through structural changes in the economy.
- Cherry model: It concludes that there is a direct relationship between individual income rates and structural changes in GDP in these countries.

### ***2.2.6.3 New-Classical Theory***

Since the early 1980s of the previous century, the neoclassical theory prevailed in the United States of America, Europe, Canada, and other countries. This theory has spread widely due to the authority of two major institutions in the world over development, which are the World Bank and the International Monetary Fund, which have a direct and indirect impact on economic development. The basic principle of this theory is that governments shouldn't interfere in the economy and that the most efficient and effective means to achieve the required level of economic development in developing nations is through market liberalization, privatization, and encouragement of trade and export (Islam, 2004, P. 217).

According to this theory, economic regress and the slowing of economic development processes are solely the results of ineffective use of economic resources due to ineffective economic policies imposed by governments, particularly price policies and unjustified interference in economic activities (Islam, 2004, P. 222).

### ***2.2.6.4 New Growth Theory***

Even though the term "growth" appears in the theory's name, thus it is one of the more recent theories of economic development. Analyzing the variables that influence a country's growth in the gross national product is essential to understanding the causes of economic development.

It emphasizes factors of input and investment in human power in the first place, as a way to achieve comprehensive economic development. This theory has developed due to the failure of the neoclassical theory, also because of the ineffectiveness of the World Bank's prescriptions for developing countries in achieving higher rates of gross domestic product, or in reducing the indebtedness of these countries, or increasing the productivity of their economic sectors, and thus not improving the living standards of individuals in developing countries (Zalewski, I, R. 2009, P. 26).

### 2.2.7 Economic Development Obstacles

The obstacles that economic development faces and must overcome to be efficient, successful, and able to achieve its objectives vary from one society to another. Different criteria are used to categorize development obstacles, but they all result in putting these obstacles into specific categories through which they can be understood and studied. There are several important criteria upon which the classification of the obstacles to economic development can be based (IMF, 2016, Web-Published)

- **Natural obstacles:** They consist entirely of natural factors like climate, soil, arable land, geographic location, an abundance of water, and natural resources. The existence of countries in unfavorable natural conditions creates a barrier to their development in them, but that in no way implies that these countries are necessarily economically backward than others in terms of their economic development. Numerous developed countries have been able to overcome these conditions by inventing manufacturing methods, in order to achieve the best work performance. The best example of this is Japan, which, despite having a dearth of energy and mineral resources, has been able to achieve the highest levels of progress thanks to effective management and the development of its economy using the resources that are available.
- **Economic obstacles:** The majority of countries suffer from economic obstacles, the most significant of which is low income, which is reflected in a decline in health, nutritional, and educational situation. This entails negative effects in the medium and long run, leading to a diminished in workers' productivity and a decline in efficiency and effectiveness. Thus, the low level of income leads to a decrease in the rate of savings and a decrease in investment, in addition to the obstacles resulting from the small size of the local markets, to absorb the production capacity of large factories and the weakness of the necessary infrastructure for production.
- **Political obstacles:** Political instability obstructs the economic development process because owners of capital or investors will hesitate to invest or will be afraid to do so in a geographical area that suffers from political corruption, making the political factor a significant component in the development process. Therefore, the

more stable and secure the country is at present and in the future, the greater the capital inflow. Decisions regarding investments, finances, and development initiatives depend on the effectiveness of the stability-related factors. An unstable environment makes the performance of the economy restricted, and makes the development of that economy difficult, if not impossible.

- **Technological and organizational obstacles:** Advancing the wheel of economic development requires the availability of modern work methods, modern organizations, and appropriate human resources. Due to the crucial contributions to the success of development, it also necessitates the need to shift away from conventional and complicated ways and effort to include the technical component. However, the inability to introduce modern technology, as a result of the lack of an appropriate environment, is considered an obstacle in the face of economic development.
- **Social obstacles:** There are some outdated and prevailing social values in societies, especially developing ones, which stand as an obstacle to development. Work has specific characteristics and responsibilities, and appointments are often not based on capabilities, competencies, and experiences, but rather on clan favoritism and sectarian and partisan mediations, which leads to the presence of a large number of workers behind offices, and production is little or what can be called disguised unemployment.
- **Obstacles of corruption:** Failure in attracting foreign investment and local capital flight. A free competitive environment, which is necessary to entice both domestic and foreign investment, is incompatible with corruption. This exacerbates the problems of poverty and unemployment and results in a general deficit in the creation of work chances. Resources are wasted when personal interests conflict with public development programs, and corruption has a significant fiscal impact on public coffers as a result of the misappropriation of tax dollars. Failure to obtain foreign aid, as a result of the bad reputation of the political system. The emigration of economic talents, due to the lack of appreciation and the emergence of nepotism and favoritism in occupying public positions.

### **2.2.8 Economic Development Indicators**

Measuring economic development indicators is crucial for determining trends in development and assessing how well economic planning has succeeded in achieving the development of a country's objectives. Along with the group of social, cultural, and political indicators, economic indicators are regarded as a significant component of the group of indicators used in development studies generally. The most significant economic development indicators that are used to determine how much one country's economy is developing or trailing behind others are discussed below: (World Bank, 2019).

- **GDP (Gross Domestic Product)**

It is one of the most essential conventional economic indicators for measuring growth in the economy. The more this indicator rises, the more it reflects the strength of the country's economy. The World Bank has divided the world into five groups of countries, Based on a set of constraints in relation to the rate of national product.

- The first group consists of thirty-six countries with an average gross national product of less than 370 USD, these countries account for 53% of the world's population while contributing no more than 5% of total global production.
- The second group consists of sixty countries with an average gross national product of more than 370 USD, these countries account for 23% of the world's population while contributing no more than 14% of total global production.
- The third group consists of eighteen countries that are industrialized and have average gross national products of \$4,200 or higher. These countries account for 64% of global production but only account for 15% of the world's population.
- The fourth group consists of oil-exporting nations with a capital surplus, their average gross national product is \$5,000, and they account for 1.4% of global production while only making up 0.6% of the world's population.

- The fifth group consists of countries that up until recently practiced central planning; their average GNP is around \$4,300, and they account for 15% of global production despite making up only 8% of the world's population.

- **GDP Per Capita**

This indicator refers to per capita GDP, which is calculated by dividing the gross domestic product by the total population and represents the value of goods and services produced by one person in a country's economy.

- **Ratio of investment to GDP**

It measures the ratio of total investments to the gross domestic product. An elevated level of this indicator indicates good finance for activities intended to achieve economic development.

- **The ratio of External Public Debt to GDP**

It is the ratio of the total debt of any country to its gross domestic product. It is best for economic development to have this ratio at its lowest level.

- **Level of Inflation**

The level of inflation is defined as the annual rate of change in consumer prices in a given year compared to consumer prices in the previous year.

- **The Surplus in the Trade Balance to the Gross Domestic Product**

The trade balance of a country is the difference between the monetary value of this country's exports and the monetary value of its imports, during a certain period of time. The preferred balance, also known as the trade surplus, occurs when exports are valued higher than imports. The trade deficit—also known as the negative balance of the state—occurs when imports exceed exports. When the trade balance is in excess, it suggests that exports are worth more than imports, which is a sign of great economic development.

- **Unemployment and Poverty Level**

The "poverty line" is the minimum standard of living, and it serves as a benchmark for measuring the level of economic development. Poverty is the lowest possible standard of living. The further a country is from economic progress, the higher its poverty level.

As is the case with the level of poverty, the high percentage of the unemployed is an indication of the low level of economic development.

### **2.2.9 FDI Contributions to Economic Development**

FDI was widely believed to be a method of transferring economic resources from the host countries to the countries exporting these investments. However, the current period has shown that most developing countries tend to compete for FDI and to take action to improve the investment climate because they feel that it plays a constructive role in developing their national economies. We will walk through the benefits foreign direct investments can bring for economic development and any potential repercussions for the national economies of those countries that host these investments (Tejima, Shigeki, 2003, P. 26).

#### ***2.2.9.1 Development Financing***

The contribution of FDI to close the local skills and resource gaps in the local economy is a crucial indicator of the viability of these investments. This impact is measured by its role in bridging the gap between the required national resources and the size of the actual local resources, in addition to its role in bridging the technical skills gap, training national workers and managers, and transferring productive art to the host countries, as a direct investment is regarded as the carrier of cutting-edge technologies and modern innovations, whether they are products or artistic means. Foreign capital and technology transfer are the two main types of foreign resources transferred to the host country. When the first wave of FDI generates a second stream of investment toward the host country, direct investment can have a beneficial financial impact. Foreign capital and technology transfer are the two main types of foreign resources transferred to the host country. When the first wave of FDI generates a second stream of investment toward the host country, then direct investment can have a beneficial financial impact. Private capital is perceived as cautious capital. Direct investment tends to continuously flow into the host country if the first experience is successful in establishing the necessary conditions for success (Gastanaga, V. Jeffrey B. Nugent and Biastra Pashamova 1999, P. 48).

Host countries should restrict multinational corporations from directing their investments into specific economic sectors in order to prevent the development of a dual economy in host countries, where the economies of developing countries are split into two sectors, one of which is technologically quite advanced and is represented by foreign company branches, and the other is technologically backward. In addition, these companies may invest in extractive industries in order to use the natural resources of developing nations without producing those resources there, which would have a limited positive impact on the growth of the manufacturing sector. Some of these companies may also not adhere to environmental safety regulations (Gorg, H. and David Greenaway, 2004, P. 19).

#### ***2.2.9.2 Capital Formation***

The positive contribution of FDI to the capital formation of the host country depends on the volume of inflows and outflows of capital. That is, on net foreign direct investment. The stock of FDI is rising in countries where foreign investors are reinvested a sizable amount of their income, in contrast to countries where capital outflows are rising. Consequently, the patterns of FDI inflows and outflows from the host country determine the FDI balance. The availability of capital for investment in new projects is among FDI's major contributions to capital formation. When foreign investors make investments in a nation, they bring in fresh money that might be used to finance new initiatives. This investment may result in the establishment of new companies, which will enhance production of goods and services and provide job opportunities. An increase in capital formation follows from this (Brainard, S.L, 1997, P. 520).

### **2.2.9.3 Foreign Exchange**

The classics believe that the presence of multinational corporations causes a rise in the rate of outflows of foreign currency relative to inflows. According to them, this is caused by a variety of factors, among the most important of which are the large volume of profits transferred abroad, and the continued transfer of a portion of the capital to the home country, the same applies to the salaries of foreign workers, and the modest amount of funds available to foreign companies at the beginning of the investment project (Bailey, 1990, P. 21).

The founders of the modern school disagree with the conventional opinion regarding multinational corporations because, from their view, MNCs aid in raising the country's share of foreign exchange. where these companies can fill the gap between the amount of savings or cash available locally and the amount of foreign exchange that developing countries require to finance development initiatives due to their vast financial resources and capacity to get funds from the foreign exchange markets. These companies can also encourage people to save by offering appealing and lucrative investment alternatives (Amuedo and Pozo. 2010, P. 329).

The existence of these companies encourages accelerating the flow and diversification of aid and grants offered to the host developing countries by international organizations and the mother country. Considering the two aforementioned points of view, the following factors determine the magnitude and scope of these enterprises' contribution to raising the amount of foreign exchange flowing into the developing host countries (IMF, 2009).

- 1- The volume of capital that the company brings in at the beginning of the investment.
- 2- The volume of loans that companies obtain from local banks, which play a positive role in attracting more foreign capital.
- 3- The degree of influence of these companies on the transfer of local savings to and from areas of effective use and production.
- 4- The volume of profits that have been recapitalized compared to the volume of profits that have been transferred abroad.
- 5- Other financial requirements needed for the investment.

- 6- The size of the investment project (large or small).
- 7- Form of investment or ownership pattern of the investment project. The fact that the projects that are entirely owned by the foreign party reinvest a sizable portion of the profits realized after tax emphasizes the significance of the kind of investment and ownership. Additionally, we discover that a project's capital intensity contributes to an increase in the amount of foreign capital coming in, particularly the sums needed for the initial investment.

#### ***2.2.9.4 Production, Employment, and Income***

FDI has a positive impact on employment and production. National companies may not be aware of the opportunities for national investment, or they may be aware of them but unable to take advantage of them due to limited financial and technical resources, whereas the foreign investor has previous experience in economic activities and more knowledge in production and marketing. As a result, it will be more able and more effective at implementing productive projects in the host countries, which will result in the creation of new jobs and revenue sources as well as an increase in labor due to the export of relatively labor-intensive goods (Craigwell, 2006, P. 33).

However, the volume that FDI contributes to domestic output and employment varies depending on the host country, and the real indicator of this contribution is the income from domestic production factors or the added value that is produced using domestic as opposed to foreign production factors. The source of the inputs used by foreign companies implementing foreign investment must be considered when estimating the contribution of the aforementioned investment in production and employment because the income of foreign companies paid for non-national factors of production does not represent a real benefit directly to the host country, except in that part of it that is spent locally. Branches of foreign companies may buy raw materials and other production necessities from the host nation, which may create the ideal local conditions for the emergence of a manufacturing industry or the establishment of complementary industries, which encourages domestic production and generates new job opportunities (Albili, 1994, P. 126).

#### ***2.2.9.5 Balance of Payments***

The first effect of FDI is reflected in the inflow of foreign capital and the growth of physical capital in the host country, and this is positively reflected on the capital account, in the event that foreign companies sell their foreign currencies in order to obtain the national currency they require to finance their local payments. At a later stage, if foreign investments are made in industries that compete with imports, they could potentially reduce the shortage of foreign currency since they help to meet a portion of the domestic market's demand. The balance of payments improves when FDI contributes to expanding the volume of exports to other countries or re-exports to the mother country. Foreign enterprises entering export markets have a higher chance of success, due to their established reputation for high quality and reliability in supply as well as their familiarity with other markets. Foreign companies typically import more capital goods at first, and as they begin to produce, the host nation's imports of finished goods and other commodities tend to gradually decline as foreign companies produce goods to meet a portion of the domestic market's demand (IMF's, 2009, Web-published).

However, evaluating this net outcome requires a comparison between the size of the improvement in the trade balance and the balance of the capital account in the host country with the volume of resources transferred from it through the transfer of capital and profits and the income of foreign workers. If the effect of improvement in the trade balance outweighs the capital account in the host country in terms of its positivity, then it is said that foreign investment is associated with a positive relationship with the balance of payments in the host country (Adegbite & Ayadi, 2011, P. 89)

#### ***2.2.9.6 Transfer of Technology and Management***

Technology is a consumable resource made up of information, abilities, capabilities, and techniques to use and manage production resources in order to produce and distribute socially and economically desirable goods and services. There are various classifications for technology, the first one is “Hard Technology” which includes mechanisms, engineering diagrams, and technical descriptions used to utilize hard mechanisms, the second is “Soft Technology” which primarily includes the fields of management, marketing, finance, and programming. One of the most significant advantages and benefits of FDI is that it is one of the most effective ways to transfer

management and productive technologies from one country to another, particularly from wealthy countries to developing countries. It is challenging to purchase technology in the monopolistic market for technology. Companies that make investments abroad are expected to possess technical expertise or unique assets that are exclusive to them and not available to others. When a foreign company enters a country, it invests in the local workforce, hires local engineers, technicians, and other workers, and thus strives to train them to operate the machinery it brings. As a result, the local population absorbs this new technology, which is advantageous to the country's developing economy (Hadija, 1994, P. 127).

However, it should be noted that international companies' branches do not fund research and development activities in developing nations, instead, they choose to concentrate these activities in their main offices, which are located in developed countries. This practice is justified by the argument that research and development activities are difficult to coordinate if they are conducted in a decentralized manner. Additionally, FDI may not always play a huge role in the area of providing national labor with modern technology capabilities due to the meager job opportunities produced by these investments due to the use of capital-intensive technological methods (Chia, S. Y. 1997, P. 235).

#### **2.2.10 Role of FDI in Achieving Economic Development**

FDI plays a significant role in achieving economic development as an income generator by increasing the value of total production and raising economic growth rates in the short and long term through a number of methods, the most significant of which are lowering imports and raising export-oriented production. This singlehandedly improves the trade balance, which improves the balance of payments, and increases the flow of foreign capital. Multinational corporations through FDI contribute to the process of economic development by delivering tangible and intangible assets such as capital, technology, and organizational skills. FDI is a key factor in enhancing the effectiveness of domestic investment Through the influx of foreign capital and local savings, which raises the benefits of these investments and, in turn, boosts savings. Also, it lowers unemployment through new projects conducted by multinational corporations to operate their own businesses, as well as raising the level of economic development, which is done

through implementing medium- and long-term development projects and making use of the financial and in-kind capital that FDI provides, as well as the favorable effects it has on the country's commerce and economy (Borensztein, 2001, P. 99).

With the purpose to develop projects directly, FDI helps bolster economic potential by investing in new sectors, or other economic activities, which diversifies the economy in the first place. It also adds a component of increasing competition by building current institutions and enhancing their capabilities. All this works to increase the economy's level of competition, which serves as a catalyst for economic development. When discussing the level of wages in developing countries and the impact that FDI has on it, we also include the impact of FDI on wages, which is the difference between the wages provided by local companies and the wages paid by multinational corporations is endemic to the level of the host economy. We discover that the public's familiar traditional perspective is in favor of the latter and acknowledges the high level of pay at its level. FDI also has a significant and direct impact on competition in host countries because the localization of multinational corporations will strongly support economic development by stimulating competition at the local level, which translates through improved productivity, lower prices, and effective allocation of available resources (De Mello, L, 2005, P. 96).

The transfer of technology and the development of human capital are regarded as the most significant benefits of foreign direct investment. By providing the administrative and technical skills for their projects, which in return pushes local rivals to profit from enhancing their technological capabilities and implementing strategies to increase labor and management productivity and, thereby, increase the local labor force and develop the technology. The effect of FDI on human capital is visible in an indirect manner because it either results from the knowledge and experience gained through local workers' interactions with multinational corporations or from legislation enacted by host country governments as constraints on these companies in order to guarantee that they provide the most benefit in the area of qualified local human capital. These effects go beyond the level of workers present at the level of multinational companies to also include the human capital available to local companies through the transfer of qualified workers to local companies or through local suppliers whose skills are improved to increase the quality of

goods supplied to multinational companies through standards that imposed on them by these companies (Durham, 2004, P.285).

Finally, as trade and investment become more and more complementary, FDI contributes to expanding business opportunities while also benefiting the environment and society. Over time, this will result in a rise in the nation's environmental and social standards as local companies adopt these standards. FDI may have a stimulating or discouraging effect on local investment as a result of the tendency of foreign investors to rely on financing a portion of their investments by borrowing from the local market of the host country. This results in a decrease in the share of local investors from the amount allocated to finance their investments due to the transfer of part of the local savings to FDI (Edwards, S, 2006, P. 34).

### 2.2.11 Previous Studies on FDI

previous studies serve as the primary pillar on which the subject of the study is constructed since they represent the theoretical framework and the research's objectives of creating a framework. This study examined many research papers on FDI, which were analyzed and organized by publication year into groups.

<b>Researcher, Title, and Year of Publication</b>	<b>The most important goal</b>	<b>The most important results</b>
The Impact of FDI on economic growth in Algeria By: Abdul Ghader Ali 2014	The thesis seeks to evaluate the impact of FDI, imports, and domestic investments on Algeria's economic development.	The findings imply that productivity and export, as well as FDI and production, are positively correlated. They discover that drawing FDI boosts production growth.
FDI and Economic Growth in Uganda: Evidence from Vector Autoregressive Model	The paper examines how FDI affects economic growth and evaluates the factors that	International financial flows are crucial for promoting economic growth in Uganda,

By: Maxwell Odongo 2012	influence FDI inflows to Uganda.	according to the report. The results also showed that domestic investments, GDP growth, export and import growth, and growth in FDI inflows are all crucial factors.
Attracting FDI in Pakistan. A Qualitative Study. By: Ayaz Bhatti 2011	The purpose of this paper was to investigate the reasons behind the decline in FDI in Pakistan, to identify potential obstacles to FDI with regard to Pakistan, and to identify and suggest policy measures to attract FDI using a qualitative approach and secondary sources.	According to this study, Pakistan's overall economic environment is negatively impacted by terrorism, political unrest, and corruption, which are the main factors deterring FDI.
Foreign Direct Investment. A Review of the Determinants and Economic Effects. Book 2019	This thesis offers a conceptual summary of some of the most commonly discussed economic causes and effects of FDI in the literature.	The results concluded that because FDI is both a driver and an effect of economic growth, the combination of direct and indirect effects leads to the conclusion that all of these effects have an impact on economic growth.
Modelling the system-wide impact of FDI in Scotland, an ownership-disaggregated regional computable general equilibrium (CGE) analysis. By: Gillespie, Gary 2000	The main goal of this thesis is to create a modeling framework that can be used to analyze the effects of FDI on Scotland's entire economic system.	The study found that both the ownership disaggregated I-O database and the ownership-disaggregated I-O and CGE models can have a significant effect on the estimate of total FDI supported employment.

<p>FDI and Corruption: An Econometric Analysis of the Multidimensional Effects of Corruption upon FDI Inflow. By: Vegard Kolnes 2016</p>	<p>The main goal of this thesis is to ask the following research question in order to determine the impact of corruption on the levels of FDI inflow: What impact does corruption have on a country's level of inflow of foreign direct investment?</p>	<p>The thesis reveals that context has a significant impact on how corruption behaves. In this thesis, it is discovered that corruption can sometimes have a beneficial impact on FDI inflow. Unfortunately, the data regarding the various forms of corruption are not of a quality that allows for accurate estimations. The findings clearly demonstrate that disagreement in the area is caused by systematic discrepancies resulting from various estimation approaches and an overly simplistic definition of corruption.</p>
<p>Essay on foreign direct investment, institutions, and economic growth. By: Fathi Ali 2015</p>	<p>The purpose is to examine and research various aspects of the interaction between one of the most crucial aspects of institutional quality, namely property rights, and a crucial component of economic integration, FDI, and how these factors relate to economic growth.</p>	<p>The findings demonstrate that in order to take advantage of the positive externalities provided by FDI, a host country must attain a minimum level of institutional quality. Chapter 5 examines whether the positive effect of FDI on institutional quality in host nations may be seen as a new growth-enhancing function for FDI based on the findings of Chapter Three.</p>

<p>FDI and economic growth in Nigeria: an analysis of the role of financial development on linkages in Nigeria.</p> <p>By: Amadi, Chibuzo</p> <p>2019</p>	<p>This thesis, which is a novel contribution to the literature, looked at the relationship between FDI and economic growth in Nigeria as well as the function of financial development in boosting the advantages of FDI flows to Nigeria.</p>	<p>Results indicate that whereas financial depth and stock market capitalization are adversely connected with growth, stock market liquidity is a positive driver of growth. This research has significant managerial and public policy ramifications.</p>
<p>The Relationship Between FDI and The Macro Economy.</p> <p>By: Kekec, Ibrahim</p> <p>2011</p>	<p>The paper investigated the relationship between the aggregate unemployment rate and FDI inflows and outflows.</p>	<p>The findings demonstrate that FDI inflows and outflows are not factors in determining the overall unemployment rate. Additionally, in accordance with macroeconomic theory, the level of aggregate unemployment in the past has a favorable influence on the level of aggregate unemployment today.</p>

After reviewing the results of the previous studies, the researcher observes the following:

- 1- Foreign direct investments are critical because of their involvement in the formation of countries' economies.
- 2- countries that attracted FDI are more productive and attain their objectives and they managed to take advantage of the privileges these investments bring to the country.
- 3- Some countries have flaws in their investment climate, as well as flaws in their measurement.
- 4- Achieving all the objectives of FDI is a goal for governments, thus researchers and authors are more focused on looking for elements that increase FDI.



### **3 Chapter III: Research Methodology**

#### **3.1 Introduction**

For proper research methodology, appropriate research evaluation and development are required as it will produce more valid and accurate output along with convincing data analysis.

A descriptive method has been used to provide a better understanding of the relationship between foreign direct investments and economic development in Yemen and explain the core concept. As this approach is based on presenting and describing existing data obtained from analytical studies and other sources on FDI and showcasing how the Yemeni economy reacted to those investments.

#### **3.2 Research Design**

A descriptive research approach has been designed and put into practice. Since this research is constructed according to the meanings taken from numbers, results collected in a standardized numerical form, and analysis directed by graphs and tables (Bryman, Alan, 2012).

This approach was used to extrapolate the findings from data and information, annual reports, research papers, and global statistics published by international organizations, as well as economic indicators focusing on FDI and economic development in Yemen (Streefkerk, R. 2022).

The thesis first started by identifying the key idea and reviewing previous relevant studies and articles, then moved to historical data to identify trends and relationships and to refine and develop the idea, then research questions and conceptual research framework were reached. The research methodology was designed, the necessary data was gathered, the obtained data were measured to provide proper answers to the research questions. Finally, the conclusion was formed and written.

#### **3.3 Data Collection Techniques**

In this research, the role of FDI on economic development was addressed during the period when FDIs inflowed into Yemen. The study is based on the data that has been published. The data was gathered from a number of publications, journals, international reports such as UNCTAD, and websites, mainly those run by Yemen's Central Bank and the Ministry of Commerce and Industry. Additionally, graphs and tables have been used

to illustrate data on FDI during the study period. A long time was spent collecting data and verifying its validity from various sources to provide a comprehensive description of the targeted sectors of these investments, the volume of them, and the amount of cash flows, as well as their impact on Yemeni economic development.

## **4 Descriptive Analysis**

### **4.1 Introduction**

This chapter includes a description of the features of the data in the study, a presentation of tables, infographics, and a brief overview of the Yemeni investment climate and laws. A broad and holistic picture of the FDI contribution to the Yemeni economic cycle and obstacles to FDI in Yemen was provided, as well as SWOT analysis.

### **4.2 FDI and Investment Laws in Yemen**

The Republic of Yemen is an Arab country in western Asia, southwest of the Arabian Peninsula. According to demographic projections for the year 2023, it has a land area of around 527,970 square kilometers (this is after North Yemen and South Yemen united to form one republic with the name of the Republic of Yemen) and a population of 31,750,603 people. Yemen has a southern shore on the Arabian Sea and a western coast on the Red Sea, and it borders the Kingdom of Saudi Arabia to the north and to the east of the Sultanate of Oman. More than one hundred eighty islands in the Red Sea and the Arabian Sea belong to Yemen, with Socotra and Hunish being the two largest. The constitution of Yemen acknowledges the country's democracy, supports partisan and political plurality, the adoption of a free-market economy, and adherence to international agreements and agreements outlined in the Universal Declaration of Human Rights. Yemen is a member of the Organization of Islamic Cooperation, the World Trade Organization, the Non-Aligned Movement, the League of Arab States, and the United Nations (Yemeni Ministry of Industry and Trade website).

Yemen is the 160th member of the World Trade Organization after it met the requirements for approval of membership by its executive and legislative powers in 2013. The World Trade Organization's ninth global meeting of trade ministers held a session in Indonesia during which they approved the documents accepting Yemen's accession to the organization. As a result, Yemen was considered a member of the organization, and this accession was considered a great achievement for Yemen and its people.

Additionally, this approval was considered an opportunity to open up plenty of employment prospects, spread investments across various industries, particularly in economic development, and boost the investment climate in Yemen. However, Yemen entered a perilous political wave in March 2014, one year after joining the WTO, and a war erupted across the country. This had a detrimental impact on Yemen's political situation and made it unstable and risky. This also made the country's economy entirely unpredictable, which had a detrimental impact on Yemen's ability to attract international investment and caused several foreign companies that had already begun operating there to withdraw (Musibah, A. 2015, P.71).

Due to this, the Republic of Yemen has become an economically underdeveloped country that is heavily dependent on foreign aid despite having access to oil resources. In addition, structural issues have become more prevalent, the most significant of which is corruption, as well as a variety of conflicts, and a tribal mentality that governs officials. Economic activity in southern Yemen was dependent on "Aden Port," which was negatively impacted by the closure of the "Suez Canal". In 2011, the rate of industrial output growth was 9%, and the percentage of GDP growth was (-10%). The development of the qat tree also had an impact on coffee exports, which made up 20% of the GDP. The unemployment rate in 2020 reached 13.57%, the number of people living below the poverty line (less than two dollars per day) is 55%, and 18.4% of the population suffers from extreme poverty, Yemen recorded a deficit in the current account of -\$1 billion in 2021, the public debt averaged 58.39% of GDP from 1999 to 2022, and the rate of inflation in 2021 reached its peak at 45.7% in the CPI. For instance, Ali Abdullah Saleh's (the former president of Yemen) government was ranked 146 out of 178 in Transparency International's 2010 corruption index. (Medici, A. M. 2012, P.12).

#### **4.2.1 Investment Laws in Yemen**

Before discussing Yemen's investment laws and the privileges and exemptions offered to foreign investors, it is important to note that Yemen is a member of both regional and global organizations (Yemeni Ministry of Industry and Trade website, 2015).

- 1- MIGA International Investment Guarantee Corporation.
- 2- The Arab Investment Guarantee Corporation.
- 3- The Islamic Corporation for Insurance of Investment and Export Credit.

For Yemen being a member of these organizations ensures that the country must protect foreign investors against any non-commercial risks whereby it makes any type of investment in the country safe and guaranteed.

#### **4.2.1.1 Legal Environment**

A beneficial and supportive legal environment existed in Yemen for investment. Economic regulations that have been issued by the government provide incentives and facilities for investors.

Investment Law No. (22) of 2002, a replacement for Investment Law No. (22) of 1991 and its amendments, organizes and stimulates investment and offers facilities and incentives to investors in all industries, with the exception of:

- 1- Manufacture of weapons and destructive materials.
- 2- Exploration and extraction of oil, gas, and minerals.
- 3- Trade funds, wholesale, import, and retail.
- 4- Industries that degrade the environment and health

#### **4.2.1.2 Exemptions**

Yemen has introduced exemptions for foreign investors which were under the law No. (22) of 2009 (Yemeni Ministry of Industry and Trade website, 2015).

- 1- Exempting the fixed assets necessary for starting, growing, or developing investment ventures from taxes and customs fees.
- 2- Animal, agricultural, and fish production requirements are exempt from customs and tax obligations, and production requirements for other projects are exempt from half of all customs obligations for ongoing and registered initiatives.
- 3- projects in the major cities (Sana'a, Aden, Taiz, Hodeidah, and Al-Mukalla) are exempt from profit taxes for a period of seven years. For the remaining regions of the republic, the exemption period extends for a period of two years beginning on the first day of production or activity, and this term may extend for a further two years, provided that the overall exemption term did not exceed 16 years. For each of the following scenarios that were actualized in the project:
  - A- Projects owned by publicly traded companies that have at least 25% of their paid-up capital subscribed by the public.
  - B- Projects with a local fixed asset percentage more than 25% of the overall project fixed asset value.

- 4- If the project incurs losses during the exemption years, it must be recycled within three years of the first year following the exemption years.
- 5- Exempting exports from any kind of taxes and fees.
- 6- Real estate tax and fees for recording project establishment contracts, together with all other contracts connected to the project, are exempt from till the project is completed.
- 7- Exempting projects from paying income tax on the profits they distribute.
- 8- When projects are expanded, the same tax breaks are given for the same durations while considering the value of additional capital.

#### **4.2.1.3 Guarantees**

- 1- Projects must not be nationalized, and their funds cannot be taken, confiscated, frozen, conserved, or placed under guardianship without a court order.
- 2- The potential for the non-Yemeni investor to own all of the project's assets, including their lands and properties.
- 3- Equality in all rights and obligations between Yemeni and non-Yemeni investors.
- 4- The exclusion from establishing mandatory pricing on investment project products.
- 5- Investors have the right manage their projects without any constraints.
- 6- Granting investors free discretion to select one of the following processes for resolving disagreements that emerge between them and the state when enforcing the law.
  - The International Convention for the Settlement of Investment Disputes between countries and citizens from Different Nationalities.
  - The unified agreement to invest Arab capital in the Arab countries.
  - Any international or bilateral agreement to which the Republic is a party.
  - The International Law Commission of the United Nations' commercial arbitration policies and processes.

#### **4.2.1.4 Facilities**

- 1- Providing the investors with the information they need.
- 2- Easy procedures for bringing in foreign expertise that is not existing locally.
- 3- The simplicity with which investment projects can be established, expanded, or developed.
- 4- The simplicity of the procedures for establishing investment companies and opening branches.

- 5- Having a single point of contact with the authority.

### **4.3 Analysis of the Investment Climate in Yemen**

The Republic of Yemen previously, prior to 2010, had a number of investment ingredients that made it a magnet for local, Arab, and foreign investments. These ingredients included its strategic location directly overlooking international maritime shipping lines between Europe and Asia (it is only a matter of hours away from the international shipping line.), as well as its status as the main gateway to the East of the African continent. And it has a coastal strip that extends over 2500 km along the Red Sea, Gulf of Aden, and Arabian Sea shores, as well as an abundant fish wealth that draws the world's attention. Additionally, Yemen's territorial seas are home to a large number of islands, including more than one hundred eighty Yemeni islands spread across the Red Sea, the Gulf of Aden, the Arabian Sea, and the Indian Ocean. These islands are eligible for Arab and foreign tourism investments. The islands were chosen as a focus to draw investments from each sector. In addition to the benefits and incentives provided to local, Arab, and international investors under Yemeni investment law, the Republic of Yemen is a frontier market with a wide range of lucrative investment prospects. The Yemeni investment law is regarded as one of the best in the Arab world due to the advantages and privileges offered to investors (Central Bank of Yemen 2013).

In addition to its membership in organizations working in the field of investment that work to protect and grow investments and provide the right environment for them, the Yemeni government is becoming increasingly interested in issues related to investments. It is working to create the right environment for investments through political and economic reforms as well as the introduction of numerous laws regulating and protecting the investment process. There are several investment prospects in Yemen in a variety of service and production industries such as the followings: (Al Abbadi, 2009, P. 317).

- 1- Agriculture and fishing.
- 2- Tourism sector.
- 3- Industry.
- 4- Health sector.
- 5- Education sector.
- 6- Oil, gas, and minerals.
- 7- Investing in free zones (Yemeni islands)

Yemen has several strategic appealing advantages that make it an investment destination for multiple countries, some of the strategic advantages are as follows:



**Figure 4.1** Map of Yemen

Source: Quora.com

- **Location:** As shown in Figure 4.1, Yemen possesses a strategic geographic location overlooking the international marine shipping lines connecting Europe and Asia. And it is the main gateway to the east of the African continent.
- **Labor:** Yemen's labor force stands out for its low cost, competitive ability, and high skill level.
- **Coastline:** Yemen's coastline extends for more than 2500 km along the Red Sea, Gulf of Aden, and Arabian Sea shores, and the Yemeni regional waters are rich in fish, drawing much attention globally. More than 183 Yemeni islands, which are dispersed across the Red Sea, the Gulf of Aden, the Arabian Sea, and the Indian Ocean, are located within Yemen's territorial waters. A focus island from each industry was chosen as a way to draw in investments. These investments were eligible for both Arab and foreign tourism investors.
- **The General Investment Authority:** Yemen established the general investment authority in March 1992 by Investment Law No. (22) in 1991 as a body in charge of arranging and promoting investments. The International Investment Promotion Agency presented the Authority with the Best Promotional Performance in the Middle East and North Africa award in 1998.
- **Oil Reserves:** As of 2016, Yemen had 3,000,000,000 barrels of proved oil reserves, placing it 29th in the world's oil reserves, which totaled 1,650,585,140,000 barrels.

There are proven reserves in Yemen that are 137.0 times the country's yearly consumption. This indicates that there would be around 137 years' worth of oil left without Net Exports.

#### 4.4 FDI Analysis Pre-War (1990-2013)

Although Yemen received a small proportion of FDI inflows according to FDI global index, these FDI inflows still had a positive impact on the Yemeni economy, as the Yemeni economy was not extensive. In this section, the researcher will present data from 1990-2013, as this period had most of the inflows of FDI.

Total	Investments from other foreign countries	Investments from Arab countries	Year
5%	0.6%	4.4%	1996
4.75%	3.5%	1.25%	1997
7.4%	5.9%	1.5%	1998
10.6%	6.4%	4.2877	1999
21.9%	10.9%	11%	2000
8.8%	1.3%	7.5%	2001
31.1%	0.1%	31%	2002
41%	14%	27%	2003
10.7%	0.7%	10%	2004
50.6%	1.8%	48.8%	2005
58.7%	0.3%	58.4%	2006

**Figure 4.2** The percentage of foreign direct investments inflows to Yemen 1996 – 2006

Source: The General Authority for Investment in Yemen.

As shown in Figure 4.2, FDI to Yemen kept flowing and increasing noticeably to amount 21.9% in 2000. Arab countries were heavily investing in Yemen more than other foreign countries, due to the fact that the Arabic language is the common- speaking

language used, also the geographical closeness played a key role for Arab investors to invest in Yemen as the Yemeni government offers beneficial and attractive privileges, most of the investing Arab countries were (Qatar, Oman, and UAE) as shown in Table. However, FDI inflows started to deteriorate in 2001, from both Arab and foreign countries, due to the political conflict that occurred between the political parties. Moreover, FDI inflows surged back again in 2002 to reach 31.1% and kept on rising to amount 58.7%, but they all inflowed solely from the Arab countries, and only a small proportion of inflows was from foreign countries.

<b>Year</b>	<b>Amount</b>
<b>1990</b>	<b>-131</b>
<b>1991</b>	<b>283</b>
<b>1992</b>	<b>718</b>
<b>1993</b>	<b>903</b>
<b>1994</b>	<b>16</b>
<b>1995</b>	<b>-218</b>
<b>1996</b>	<b>-60</b>
<b>1997</b>	<b>-134</b>
<b>1998</b>	<b>-214</b>
<b>1999</b>	<b>-308</b>
<b>2000</b>	<b>6</b>
<b>2001</b>	<b>136</b>
<b>2002</b>	<b>102</b>
<b>2003</b>	<b>6</b>
<b>2004</b>	<b>144</b>
<b>2005</b>	<b>-302</b>
<b>2006</b>	<b>1.121</b>
<b>2007</b>	<b>917</b>
<b>2008</b>	<b>1.554</b>
<b>2009</b>	<b>129</b>

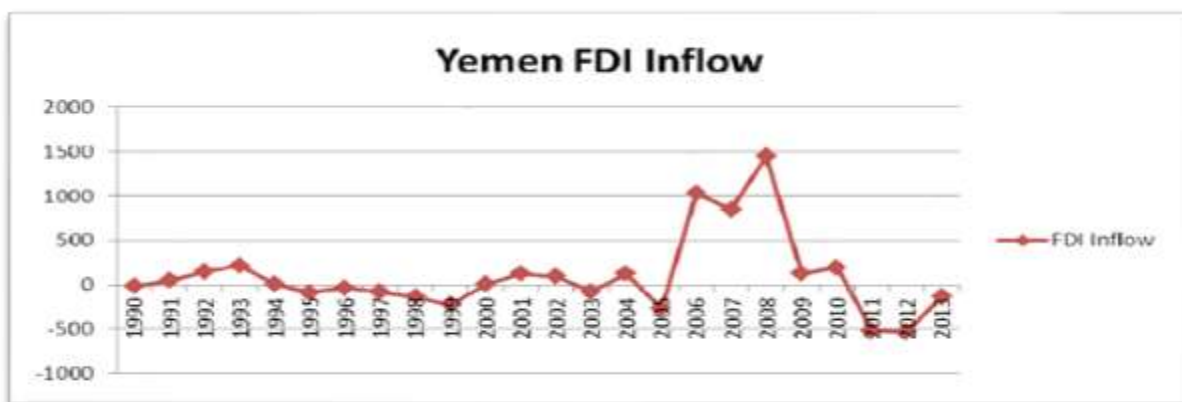
**Table 4.1** The amount of foreign direct investments inflows to Yemen 1990 – 2009 (Million Dollars)

Source: World Bank, Economic Indicators

AS shown in Table 4.1, the data indicate that there is a constant fluctuation in the volume of foreign direct investments during the period before the implementation of the economic reform program (1990-1994). We notice that FDIs were negative in 1990 -\$131 million, then it hit a spike at \$283 million in 1991. These investments reached elevated levels amounting (\$718–\$903 million, respectively) in 1992–1993. However, in 1994, these investments witnessed a sharp decline decreasing to \$16 million. In general, the

average volume of these investments during the period (1990-1994) amounted to \$357.68 million. According to the World Investment Report 2009, Yemen received over 30% of its total foreign direct investment (Table 4.1), amounting to \$1.5 billion (which was the last spike in FDI inflows) and \$917 million in 2007 and 2008, respectively. 2019 was the final data report on foreign investment in Yemen that the Yemeni Trade and Industry Ministry officially published.

The percentage of foreign direct investments to the GDP at current prices also increased during the mentioned period from (3.40-%) in 1990 to (19.37%) in 1993, whereas the percentage of foreign direct investment to the GDP in 1994 did not exceed (0.32%), causing the average ratio of foreign direct investments to current GDP during the period (1990-1994) to be (7.92%). The ratio of direct foreign investments to fixed capital formation increased during the period (1990-1994) from (27.43%) in 1990 to (90-110%) in 1993, with an average annual growth rate of (42.38%), and with a decrease amounting to (1.71%) in 1994.



**Figure 4.3** FDI inflows to Yemen (1990-2013)

Source: UNCTAD,2013

As shown in Figure 4.3, Yemen is one of the under-performing countries since its Inward FDI Potential Index is lower than its Inward FDI Performance Index. Yemen was listed by UNCTAD as one of the countries that were underperforming their potential in 2009, and it was recommended that Yemen considers measures to improve its investment climate and increase its share of global FDI inflows (UNCTAD).

Yemen's FDI inflows remained at low levels by 2009, according to UNCTAD, and on top of that, they had sharply decreased and had been negative for a while. This shows

that foreign investors have returned their previous investments from earlier years. Additionally, according to the General Investment Authority in Yemen, from 1992 to 2008, almost 27% of the registered investments failed, with foreign investments making up the majority of these failures (UNCTAD).

The Yemeni government has worked hard to entice foreign investors by establishing a legislative framework and running advertising campaigns. By establishing the Yemeni General Investment Authority in 1992 and enacting the Foreign Investment Law, it took its first move toward luring FDI inflows. A new Foreign Investment Law was also released in 2002 to better promote FDI. It also created a particular center to shorten the time needed to authorize and register investments. (UNCTAD, 2009). To encourage FDI flows, the nation has also implemented other incentives. The Yemeni government currently allows 100% foreign ownership, offers income tax vacations, and waives import duties. Furthermore, tax profit exemptions and other incentives in the form of a free zone could be granted for 15 years (UNCTAD). Foreign investors' withdrawal from the country was cited by UNCTAD as the cause of the negative value of inward FDI in the country. Yemen specifically experienced negative values in 1995–2000, 2003–2005, 2011, and 2012. Although they somewhat increased to \$130 million in 2013, FDI inflows in Yemen continued to be negative. International studies like those from UNCTAD (2013) and the World Bank can be used to explain Yemen's notably low FDI and its limited contribution to economic growth. (2013). Such reports demonstrate the unfavorable impact of Yemen's poor GDP, exchange rate, and corruption on FDI inflows. additional reasons suggested for this poor contribution are:

- Yemen's lack of focus to raising its level of openness.
- Oversight the crucial role that macroeconomic policy plays in attracting FDI.
- Yemen's political instability.
- Lack of attention to the business climate to draw in the expected level of FDI inflows.
- Obsolete infrastructure
- The rising levels of corruption that have a damaging impact on FDI inflows into the country.

Years	Registered projects			implemented and under implementation projects.			% of Implementing of investment capital
	No.	Investment cost	No. of worker	No.	Investment cost	No. of worker	
1992	202	15,177,822	4,490	132	12,727,715	2,035	65.35
1993	271	22,460,193	3,873	172	13,397,854	2,709	63.47
1994	187	18,636,634	3,976	115	6,359,364	1,921	61.50
1995	324	67,268,947	6,330	171	26,692,098	3,302	52.78
1996	444	91,722,989	9,742	215	39,750,600	3,634	48.42
1997	501	107,049,884	19,250	310	65,861,186	7,413	61.88
1998	498	71,645,362	18,584	354	48,506,481	7,324	71.08
1999	406	81,508,216	18,127	262	58,260,768	6,430	64.53
2000	388	133,550,976	13,801	262	86,897,780	5,410	67.53
2001	364	82,707,322	12,995	276	44,929,776	8,251	75.82
2002	387	101,721,431	15,790	297	81,378,420	7,012	76.74
2003	338	93,468,540	14,853	233	78,988,878	7,352	68.93
2004	399	111,589,386	13,566	279	87,666,668	9,354	69.62
2005	410	138,569,793	14,092	299	103,796,123	8,362	72.93
2006	361	292,436,013	11,836	185	128,747,660	7,162	51.25
2007	360	277,297,380	13,143	138	84,694,779	4,584	30.54
Total	5,840	1,796,837,888	194,448	3,700	968,656,150	92,255	

**Table 4.2** Comparison between the numbers of the registered investment projects at the GIA and the implemented and under implementation projects (1992-2007).

Sources: CSO, 2006: Table. 1; 2007

Table 4.2 shows that since implementing Yemen's new open economic strategy and establishing the GIA, the Yemeni government has made a special effort to improve the investment climate in order to support local investors and draw Arab and global investors to Yemen (UNCTAD, 2007). As shown in Table 4.2, the total number of registered investment projects, thus reached 202 by the end of the GIA's first year of operation in 1992. In contrast, by 1997, the number of investment projects registered with the GIA had risen to its highest level, reaching 501 projects. However, the number of investment projects declined to 360 projects, recording a 28% decrease compared to 1997.

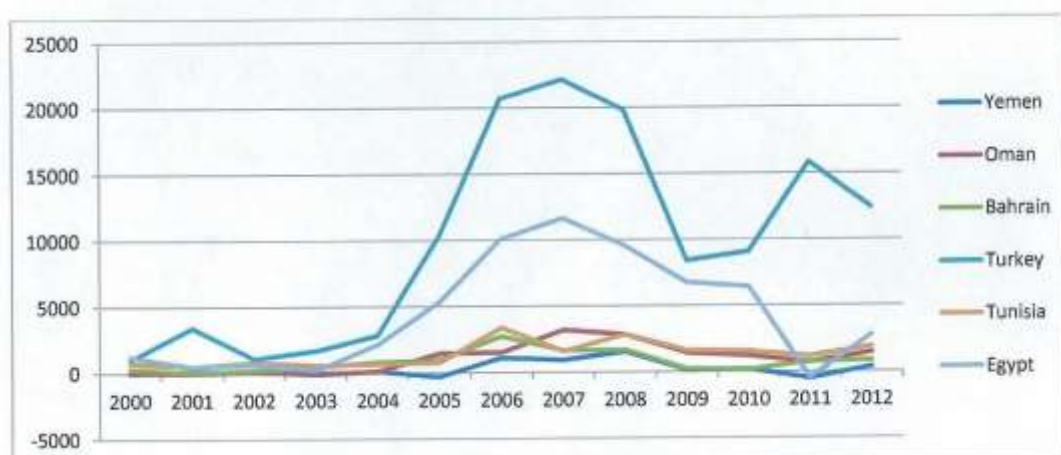
However, based on the data in Table (4.2), there is a significant disparity between the total number of projects registered at the GIA and the total number of implemented and under-implemented projects, confirming that there are significant factors contributing to the implementation of registered investment projects being delayed and occasionally abandoned. In addition, according to GIA registration and licensing data for investment projects for the years 1992–2007, the industrial, service, tourism, agricultural, and fishing sectors are where the majority of projects were registered and licensed.

Year	World*	MENA*	Yemen*	MENA/World(%)	Yemen/MENA(%)
2001	839,780	11,655	155	1.38	1.33
2002	625,815	11,786	114	1.88	0.97
2003	598,860	20,660	-89	3.44	-0.43
2004	733,597	29,499	144	4.02	0.48
2005	986,853	53,141	-302	5.38	-0.56
2006	1,474,956	84,935	1121	5.75	1.32
2007	1,999,074	90,182	917	4.51	1.01
2008	1,817,005	107,600	1,554	5.92	1.44
2009	1,216,805	87,110	129	7.15	0.14
2010	1,411,138	73,199	189	5.18	0.25
2011	1,654,284	54,496	-518	3.29	-0.95
2012	1,353,931	62,552	349	4.62	0.55

**Table 4.3** FDI Inflows in the World, MENA Countries, and Yemen, 2001-2012

Sources: UNCTAD.2012

Table 4.3 shows that FDI for the world as a whole grew from \$839 billion in 2001 to \$1.35 trillion in 2012. The total amount of direct investment received from non-resident investors over the course of a period is the country's gross FDI inflows. The rise in cross-border mergers and acquisitions in the banking sector over the past ten years, as well as expansion in the extraction and related service sectors and greenfield investments, are all responsible for the surge in FDI flows.

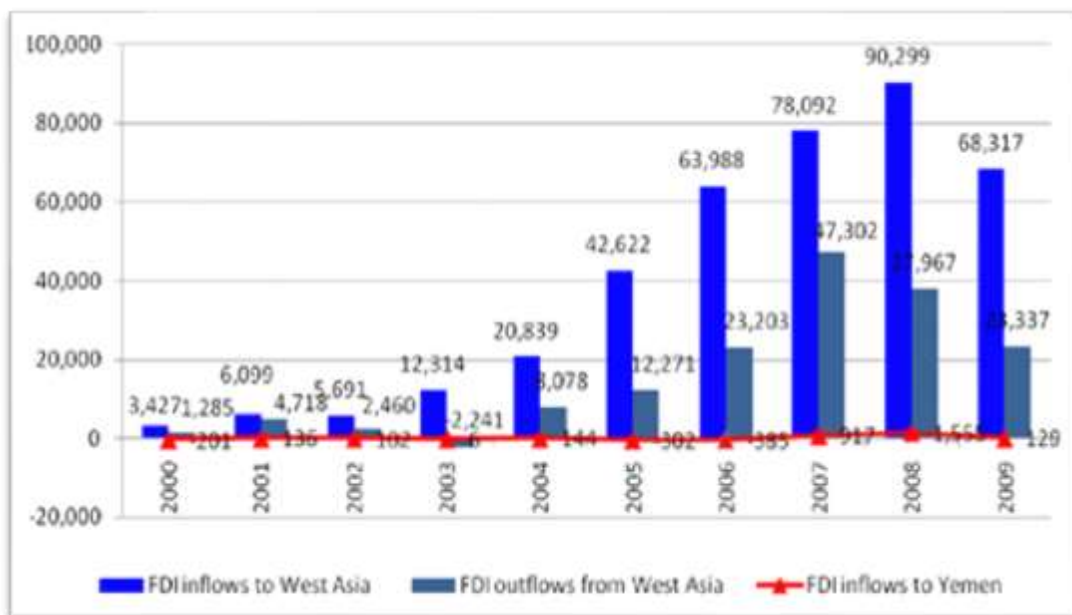


**Figure 4.4** Growth of FDI Inflows for Selected MENA Countries, 2001-2012

Sources: UNCTAD.2012

According to Figure 4.4 and Table 4.3, Global FDI inflows peaked in 2007 at approximately \$2 trillion, according to UNCTAD estimates presented in Table 4.3. This is a significant increase from \$1.47 trillion in 2006 and more than double the amount from the previous year, 2005. Even more dramatically increased FDI inflows were seen in the countries of the MENA region. FDI inflows for MENA countries as a whole surged from \$11.655 billion in 2001 to \$62.552 in 2012 despite the 1997 Asian financial crisis and political unrest brought on by the so-called Arab Spring revolution of 2011 and 2012.

Despite its economic ups and downs, Yemen even exceeded \$1.6 billion in 2008, making up 1.44% of all FDI flows to MENA countries. Furthermore, there was a sharp decline in 2011, which serves as another indication of the Yemeni economy's occasionally unpredictable changes. Figure 4.4 shows the rise of FDI inflows for a few MENA countries. Simply put, The inflow of foreign direct investments reached a record size of \$1.1 billion, and Yemen succeeded in attracting more foreign direct investments in the following two years, bringing the volume of these investments to \$1.6 billion in 2008. Still, it declined sharply after that and has remained in negative figures since 2011.



**Figure 4.5** Comparison between the FDI inflows and outflows to and from West Asia countries and FDI inflows to Yemen 2000-2009 (US\$/ Million)

Sources: UNCTAD, 2009

According to Figure 4.5, there has been an improvement in FDI inflows and outflows to and from the West Asia region. In 2007, FDI inflows increased by 12% and totaled US\$71 billion. FDI outflows from West Asia, on the other hand, rose and reached US\$44 billion in 2007. In contrast to FDI withdrawals from the West Asia area, however, FDI inflows to Yemen were extremely low.

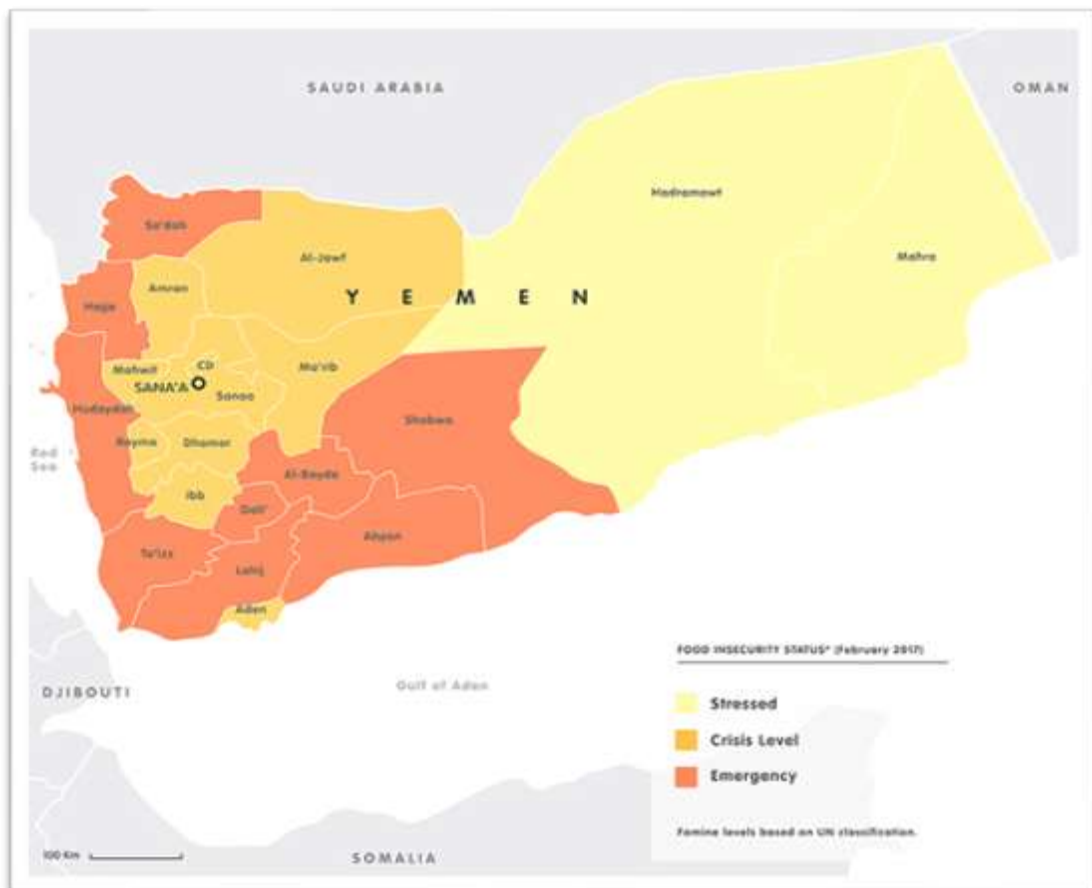
As a result, Yemen despite the considerable reforms that have been made to improve the country's investment climate, did not manage to acquire a favorable proportion of the investments inflows into the region, as well as the FDI outflows from the West Asian countries.

#### 4.5 FDI Analysis During-War (2014-2019)

The war and conflict in Yemen began in 2014, and it has negatively affected the economy which itself was already meager due to the corruption of the former president and government. This war has doubled the tragedy and led millions of Yemeni citizens to live below the poverty line. This catastrophe was initially caused by Houthi policy since they took over the capital of Yemen and seized \$4.8 billion in hard currency reserves from the central bank. After the Houthi movement took full control of the state institutions, the Houthis refused to deposit the state revenues to the central bank. On the

other hand, the official government refused to pay the salaries of government employees in Houthi-controlled areas. As a result, the central bank was relocated by the official government from Sana'a to Aden (the temporary capital of Yemen) in 2016. However, this was insufficient to find solutions that included the delivery of employee salaries (<https://sanaacenter.org>).

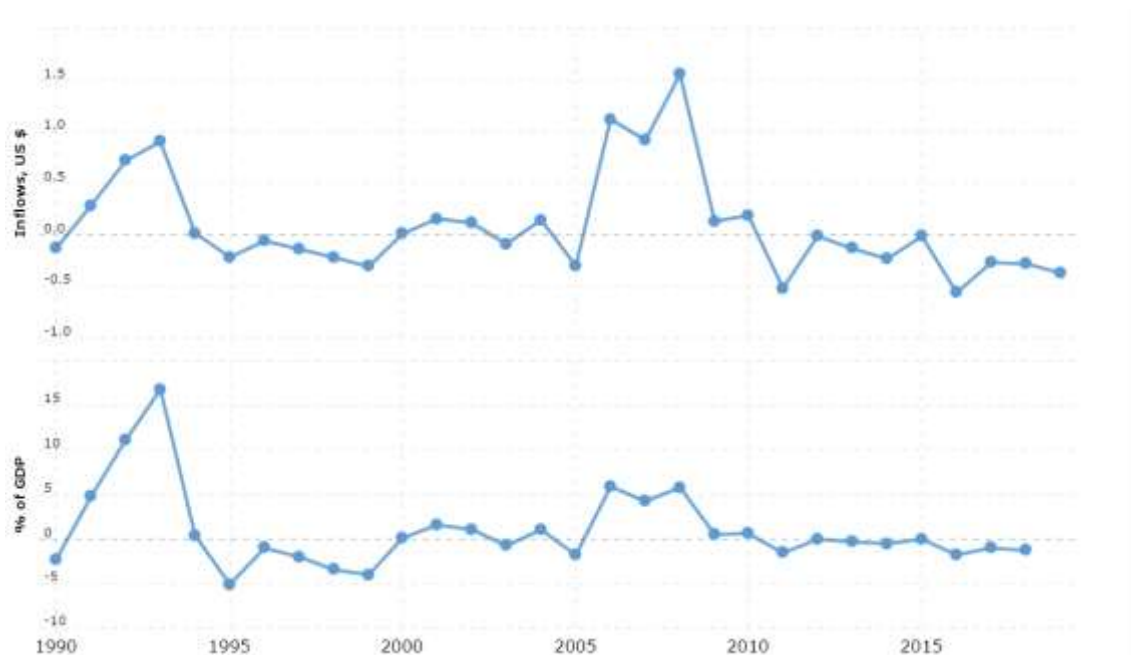
The collapse of the national currency made the economy even worse, as the exchange rate before the war was 250 riyals per dollar. However, when the war erupted, the Yemeni riyal kept dropping to reach its lowest level (1400 riyals) per dollar. The riyal's value in the provinces under government control fell dramatically, despite the steps taken by the country's central bank to slow the devaluation. At that time, Saudi Arabia deposited \$2 billion as a boost to help hold back the currency devaluation and alleviate the economic crisis, but the riyal's recovery was short-lived, and its value has since fallen again (<https://www.aljazeera.com>).



**Figure 4.6** War and conflict areas in Yemen

Source: Business Insider

Figure 4.6 demonstrates that almost two-third of Yemen's regions are in the war effect zones. The Houthi insurgents took over Sana'a, Yemen's capital and largest city, in 2014, sparking the start of the country's civil war and calling for lower fuel prices and a new government. In January 2015, the rebels took control of the presidential palace after failed negotiations, forcing President Abd Rabbu Mansour Hadi and his cabinet to resign. With U.S. logistical and intelligence support, a coalition of Gulf governments led by Saudi Arabia began a campaign of economic isolation and airstrikes against the Houthi insurgency in March 2015 (Global Conflict Tracker).



**Figure 4.7** FDI inflows to GDP in Yemen (1990-2018)

Source: [www.CEicdata.com](http://www.CEicdata.com)

Yemen Foreign Direct Investment - Historical Data		
Year	Inflows, US \$	% of GDP
2019	\$-0.37B	1.71%

<b>Yemen Foreign Direct Investment - Historical Data</b>		
<b>Year</b>	<b>Inflows, US \$</b>	<b>% of GDP</b>
2018	\$-0.28B	-1.31%
2017	\$-0.27B	-1.01%
2016	\$-0.56B	-1.79%
2015	\$-0.02B	-0.04%
2014	\$-0.23B	-0.54%
2013	\$-0.13B	-0.33%
2012	\$-0.01B	-0.04%
2011	\$-0.52B	-1.58%
2010	\$0.19B	0.61%

**Table 4.4** Yemen Foreign Direct Investment inflows to GDP (2010-2019)

Source: Macrotrends.net

In Yemen, FDI, or how many new investments were received in the country, is reported on an annual basis. It normally accounts for 2 to 3 percent of the GDP of the country.

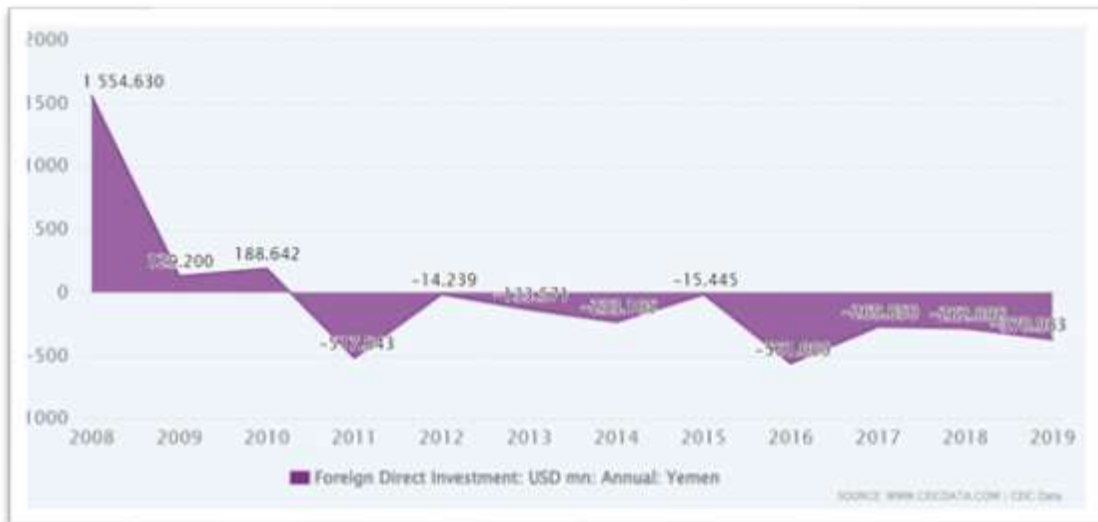
According to the historical data in Table 4.4 and the trends in Figure 4.7 that both show the amount of foreign investment inflows compared to the country's GDP in Yemen from 2010-2019, we observe that Yemen's Foreign Direct Investment (FDI) increased by \$88 millions (1.7%) of the country's nominal GDP in December 2019, compared to a decrease of (1.3%) in 2018. As shown in Table 4.4, FDI inflows compared to the country's GDP remained in negative since 2011.

In 2019 FDI inflows were \$-0.37B a 31.51% increase from 2018.

In 2018 FDI inflows were \$-0.28B, a 4.54% increase from 2017.

In 2017 FDI inflows were \$-0.27B, a 51.9% decline from 2016.

In 2016 FDI inflows were \$-0.56B, a 3532.29% increase from 2015.



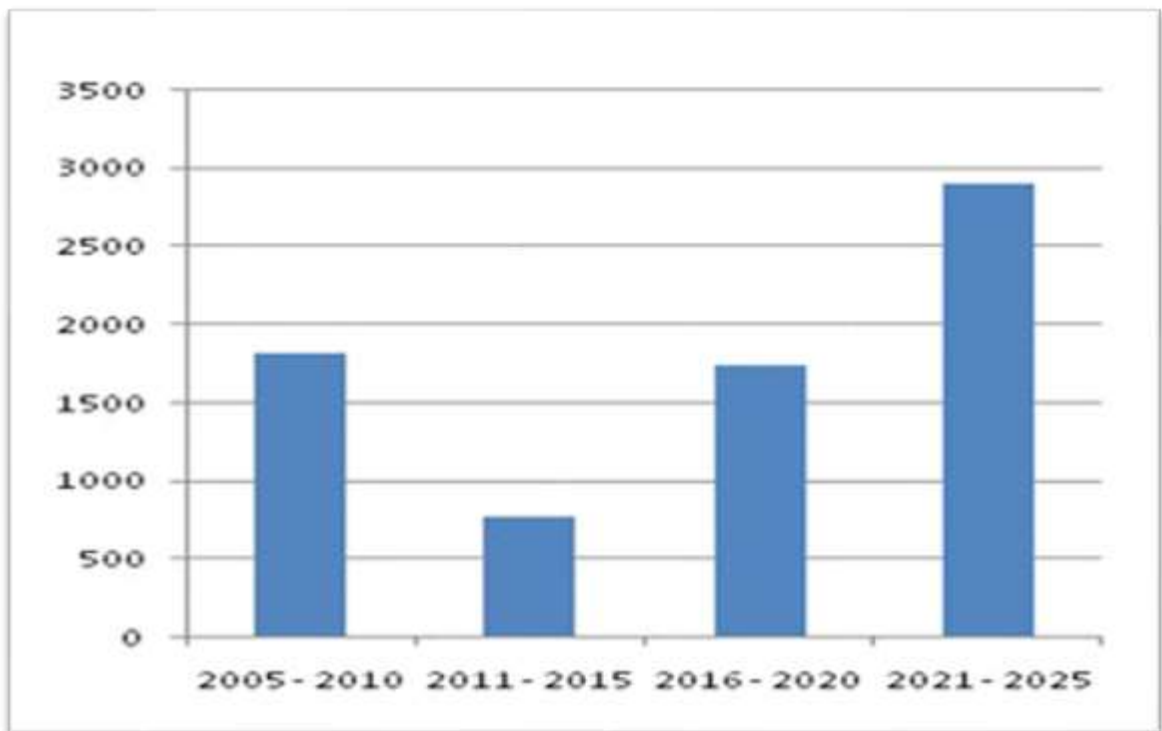
**Figure 4.8** FDI inflows to Yemen (2008-2019)

Figure 4.8 shows how FDI inflows to Yemen had stopped completely since the year 2010 and the numbers kept declining until they recovered in a small proportion in 2019. It is important to note that the Yemeni government has endured hardships as a result of its recurrent inability to export gas and oil outside of Yemen due to the political conflict and the Saudi Emirati siege of the country. Yemen managed to export its first shipment of gas and oil in 2019. However, under pressure from the UAE, the security situation is pressuring Yemen to halt exports. The UAE is charged with impeding work at the "Shihr" port in Hadramout, exporting oil through the "Balhaf" oil port, and interfering with operations at the Shabwah oil fields. As a result, this UAEs intervention

contributed tremendously to the fleeing of most of the foreign direct investments from Yemen (ACLED, 2020).

It is worth noting that some officials of the Yemeni government have indirect control over trade at the local level, allowing them to expand their direct investments in Yemen and thereby further their interests. This facilitates the spread of corruption, particularly through monopoly operations and work agreements that increase demand and thereby increase their profits, allowing them to manipulate trade policy, in addition to the shortage of goods available on the market and the use of government jobs as a front to further their agenda. They engage in agreements with international companies to make investments and offer guarantees in their capacity as indirect owners of the local market.

#### 4.6 Descriptive Statistics



**Figure 4.9** Foreign direct investment in Yemen during a period of 3 years in a million dollars, according to the World Bank report

Source: The World Bank

Figure 4.9 predicts that by 2025, foreign direct investment in Yemen might exceed \$2.5 billion and include a wide range of industries, not only those related to natural resources. The Yemen Gas Union (companies from France, Japan, and America) was awarded a new gas project, and the World Bank estimates that investments in Yemen will

increase as the project's implementation starts. Overall, Yemen's proven natural gas reserves may be used to manufacture and export 6.7 million metric tons of LNG each year for at least 20 years. Other investments in the Marib power plant and the Aden free zone will offer investment projects in the near future.

After gathering information, data, and facts about foreign investments in Yemen. The researcher discovered that there are two foreign companies that are still investing and operating in Yemen.

### 1- China Ports Engineering Company

It is the second-largest company in the world which works on infrastructure projects throughout Asia, Africa, and Europe. Projects include marine engineering, land reclamation from the sea, the construction of roads, bridges, railroads, and industries. The 1980-founded China Port Engineering Group Company and the "China Road and Bridge Company" were combined to form the business in December 2005.



**Figure 4.10** China Ports Engineering Company (CHEC) Geographical location

Source: GAC Yemen

Figure 4.10 displays the location of China Ports Engineering Company (CHEC). In 2015, the Chinese company agreed to operate and expand the port of Aden after the government of the Republic of Yemen signed a contract with the company. This was done

despite the risky and unstable economic and political environment in Yemen. China will pay \$570 million for the project to build and operate the port, which will deepen and expand the container terminal. The port is considered the first port in Yemen and one of the most strategic ports in the world for refueling ships (Yemeni Ministry of Industry and Trade website, 2015).

During the visit of President Abd-Rabbo Mansour Hadi to the People's Republic of China, the signing ceremony was held in Beijing for the expansion and deepening of the Aden Container Terminal between the Yemen Gulf of Aden Ports Company and China Harbor Engineering Company Ltd. The agreement also specifies the deepening and expansion of the turning area, the installation of massive container cranes, tractors, and RTGs for the first phase of the berth, and other utilities like a container storage yard, service facilities, administrative buildings, and a central workshop for general maintenance. This will increase the capacity to manage up to a million and a half containers per year by adding five hundred thousand containers. Additionally, it will advance Yemen and China's potential future partnership (Yemeni Ministry of Industry and Trade website, 2015).

## **2- French company (Total)**

The French company (Total) has been operating in Yemen for 36 years, as it has been running its operations in multiple oil fields and employing over one thousand workers according to the company's website.



**Figure 4.11** French company "Total" Geographical location

Source: GAC Yemen

Figure 4.11 shows the location of Total company's operations in Yemen. Total Company has implemented projects to generate electric power from the associated gas discovered in Sector 10 to serve the local communities. It is also establishing a gas power station for the use of the facilities in the sector. In addition to the good relationship that links Total with the local community in the concession areas, and its commitment to implementing social development projects and its elegant dealings with local authorities (Yemeni Ministry of Industry and Trade website).

Total is the largest shareholder in Yemen LNG with a 39.62% stake, in addition to the state-owned Yemen Gas Company (16.73%), Hunt Oil Company (17.22%), SK Energy (9.55%), Korea Gas Corporation (6%), Hyundai Corporation (5.88%), and GASSP1 (5%). The Yemen LNG project is the most significant investment ever made in Yemen, requiring a total expenditure of USD 4.5 billion. It entails transferring gas from Block 18 in the Marib region of central Yemen to the LNG plant situated at the port of Balhaf on the southern coast of the country via a 320 km dedicated pipeline. While the second train construction is still ongoing, the plant began producing the first train. A total of 6.7 million tons of LNG will be produced annually (Mt/y). The technical and

administrative teams in charge of running Yemen LNG, a business with seven hundred people, were chosen and trained by Total and its partners. Employees from Yemen are already receiving skills transfer through a three-year targeted training program in both Sana'a and Balhaf. In the future, Yemeni specialists working in all divisions of Yemen LNG—operations, administration, support, and management—will make up around 90% of the workforce. Additionally, Total has operated in Yemen since 1987. The Group currently has a 56,000-barrel-per-day production. As the operator on Block 10 (Masila Basin, East Shabwa permit, 28.57%) and a partner on Block 5 (Marib Basin, Jannah permission, 15%), Total maintains stakes in the two major oil basins (NIC Yemen, 2012).

Foreign Direct Investment	2019	2020	2021
FDI Inward Flow (million USD)	-371	0	0
FDI Stock (million USD)	1,942.1	1,942.1	1,942.1
Number of Greenfield Investments*	0.0	0.0	0.0
Value of Greenfield Investments (million USD)	0	0	0

**Figure 4.12** FDI inward and stock in Yemen (Million Dollars)

Source: UNCTAD – (Latest available data)

As shown in Figure 4.12, the overall stock of FDI was estimated by UNCTAD to be \$1.9 billion in 2021 or around 8.8% of the GDP of the country (a share that has been dropping since it peaked in 2018 at 10.7% of GDP). Yemen showed a cumulative outflow of USD 923 million between 2017 and 2019 (latest data available), as UNCTAD's 2022 World Investment Report does not include official information regarding FDI inflows to the country.

#### **4.7 SWOT Analysis of FDI in Yemen**

- **Strengths**

- 1- Yemen possesses a favorable investment climate in terms of natural, marine, and oil resources that entice investments.
- 2- Legal and procedural framework for facilitating foreign investment in Yemen, including laws, guarantees, exemptions, and facilities.
- 3- The simplicity and ease of investment-related transactions and procedures.
- 4- The third-most significant port in the world is located in the free zone in Aden governorate, which is 12 miles from the international sea line.
- 5- Yemen stands out for its strategic location, more than 2,200 km of coastline, and significant seaports along the path of the international maritime trade route.
- 6- Signing many international agreements to protect and promote international investment.
- 7- Variety of geological features and investment potential.
- 8- The World Bank's "Doing Business Report" placed Yemen 98th out of 175 countries.
- 9- Low labor costs available in the investment fields.
- 10- The ability of foreign direct investment projects to obtain loans from banks.
- 11- The freedom to manage projects by foreign investors without government intervention and there is no distinction between local, Arab, or foreign investments.

- **Weaknesses**

- 1- Some officials in the Yemeni government coerce investors to include them in the investment quota and get profits without any payment or restrictions, Under the guise of security protection "blackmail" and similar services.
- 2- The presence of ongoing conflicts makes investors concerned about their investments and properties.
- 3- Indirect market control by parties involved in Yemen's political issue.
- 4- Corruption on both financial and administrative levels.
- 5- Failing to utilize ministries and agencies to their full potential in promoting investment and bringing in investors in the manner necessary to reassure current investors or draw in new investors.
- 6- Political disputes between Yemeni parties and rebel militia.

- **Opportunities**

- 1- The lack of foreign investors in Yemen makes it appealing to invest and make money.

- 2- Yemen is a developing country that requires many foreign investments to grow and revitalize.
- 3- Yemen has a wide range of foreign investment choices, with investments in industries like agriculture, tourism, and natural resources (such as gas and oil).
- 4- The limited investments that foreigners are making in Yemen as a result of the current situation increase the potential for those who want to make investments in market control.
- 5- Insufficient domestic competition presents a chance for foreign investors to take control of the Yemeni market.
- 6- The restriction of local companies to the commercial (import, and solely acting as agents for overseas investors) rather than industrial side is considered an opportunity for foreign investments.

- **Threats**

- 1- The fluctuating value of the national local currency and the variety of exchange rates in Yemen have a negative impact on the investor since the low local currency conversion rate for other currencies reduces the investment's real value.
- 2- Lack of updated reliable data and information about Yemen's economic conditions and suitable investment conditions, particularly given the current context and continuous conflict.
- 3- The current situation's instability in the legislation governing investment in Yemen causes the investors to lose trust in their assets, which causes the investors to be unsatisfied and continually concerned.
- 4- Due to the low level of individual income, and the small population, Yemen's local market is weak. This results in a limited market's capacity for consumption, which has an impact on the investor's ability to market their products and their willingness to expand in ongoing and upcoming investment projects.
- 5- The investment climate is directly impacted by political and security unrest, and Yemen's decision-making process is becoming less under the control of its government and more dependent on other countries (Iran, Saudi Arabia, the UAE, etc.).

## **5 Discussion and Results**

In this section, the researcher will provide a holistic discussion of the study and answer the research questions and will highlight the reached results.

The role of foreign direct investment has grown as one of the sources of external funding because of the benefits it offers for economic development, the burdens it alleviates, the employment of local labor, and the reduction of unemployment rates, in addition to its significant contribution to the transfer of modern technology. Given the significance of this type of investment (FDI), most countries—developed and developing—tend to welcome it, as foreign direct investment has turned into a field of fierce competition between countries and a venue for maddening races to draw more of them.

The researcher constructed Three research main questions. Answers to the questions will be provided to meet the study’s objectives and to reach the main results.

### **- Is the investment climate in Yemen suitable for FDI?**

The war poses a significant barrier to FDI in Yemen as the investment climate worsens.

Due to the continuous conflict and political instability, Yemen has received little foreign direct investment (FDI) in recent years. Economic activity has significantly decreased as a result of the conflict, and the environment for investments has gotten worse. Property rights and business activities are hampered by corruption and the existing political climate and protracted conflict. The ostensibly independent judiciary is weak and subject to interference from the executive branch. Additionally, authorities have a poor track record of upholding court orders. In a large portion of the country, access to essential services including power, water, and health care is severely constrained. The country is highly corrupt, and according to the 2022 Corruption Perception Index, Yemen is ranked 176th out of 180. Yemen's performance on the 2023 Index of Economic Freedom reflects the unfavorable investment environment.

- **How could FDI contribute to economic development in Yemen?**

Oil investments in the volume of foreign direct investments in Yemen represent the majority of FDI inflows.

After the Yemeni unification was achieved in May 1990, a suitable investment climate was available for foreign companies. Yemen witnessed the arrival of several foreign oil corporations to establish operations in various regions. The total oil sectors in Yemen reached (100) sectors by 2010, comprising (12) producing sectors, and (31) exploration sectors. The number of operating oil companies reached (24), including (14) exploration companies and (10) production companies.

In September 2005, a long-term liquefied natural gas sale agreement was signed with a number of labor participations to export about (6.7) million tons annually, at a cost of about (4) billion during the period (2005-2010), which included the construction of facilities in the field sites in Marib and in The port of export in Balhaf on the Arabian Sea, Shabwa Governorate, and the extension of a pipeline of 320 km from the fields to the Yemeni port to the Korean markets, which achieves financial returns for the state's public treasury, and supports foreign exchange resources, as well as the results of the sector's investments on the national economy.

The FDI of oil companies slightly contributed to Yemen's economic development by creating job opportunities. For instance, during 2014 -2018, the unemployment rate decreased from 13.47% to 12.93%. Over a thousand people were employed by the French Total Company alone. Furthermore, FDI inflows to Yemen gave impetus to the local economy, by improving its ability to interact with the global economy and participate in the international production process, thus it supported the growth of oil exports.

Unfortunately, this development was short-lived, due to the institutional corruption in the state and the lack of monitoring from the government and the foreign investment-related authorities. Additionally, internal political conflict and war played a key role to make most of the foreign investments to flee and end their operations in Yemen.

- **What are the obstacles to FDI in Yemen?**

Yemen is one of many countries that promise development and modernization. However, it confronts numerous challenges and obstacles in attracting FDI. The following are the most significant ones:

o ***Lack of Infrastructure***

There are a number of factors that contribute to Yemen's weak infrastructure, which is one of the obstacles for foreign investors and a barrier to the flow of foreign direct investment in Yemen including:

- 1- Problems with the electric current, the constant cut in power.
- 2- Problems with water, Due to the irrigation of the Khat plant with groundwater.
- 3- Weak networks for wired and wireless communications.
- 4- Problems with the network of roads and transportation.
- 5- The absence of research centers with expertise in infrastructure development.
- 6- The fleeing of the creative and academic elite abroad.

o ***Security and Political Instability***

Yemen has been going through a difficult period of internal political disputes, which has had a negative impact on the investment climate. Due to this, all foreign investment companies have departed the country. Some of the incidents that happened due to the security and political instability are as follows:

- 1- The bombing of the American battleship USS Cole.
- 2- The French cargo ship Limburg incident.
- 3- The incident of a few tribes that have kidnapped tourists and some foreigners to exert pressure on the government to comply with certain demands.

o ***Lack of Professional Skills***

One of the biggest obstacles to the absence of training and job rehabilitation centers that meet industrial demand is Yemen's poor quality of education and labor skills in the investment sector. Additionally, some Yemeni workers lack computer literacy and English language proficiency, which are two fundamental building blocks in doing business with global multinational corporations.

- *Other Obstacles*

The bureaucratic system, which is a monotonous routine that the investor must endure during the initial phase of the project procedures, and which necessitates them to obtain permits, pay bribes, and obtain official approval until the implementation of the project, can be summed up as one of the most significant stifling steps the investors encounter. The lack of a modern management concept that is aligned with the international, regional, and local investment system, bad marketing services, a lack of transparency, and a lack of capital backing all result in boredom and a reluctance to continue investing.

After studying the investment environment and demonstrating the volume of FDI inflows to Yemen and discovering Yemen's poor performance in attracting FDI in recent years due to security and political instability and administrative corruption in the government, as well as the obstacles Yemen faced in different aspects. The researcher reached the following results:

- 1- Yemen aimed to draw in foreign direct investment flows by offering numerous benefits, facilities, and exemptions to foreign investors. Additionally, in order to keep up with global trends, which include the widespread use of tax incentives to attract foreign direct investment, Yemen has also worked on the issuance of several pieces of legislation that are marked by a substantial package of tax incentives, laying the legal and legislative groundwork for the investment process.
- 2- Due to the implementation of GIA, Yemen achieved the highest investment project number 501 projects in 1997, then fell to 360 projects in 2007.
- 3- The volume of FDI inflows to Yemen was modest and did not have a significant impact on economic development.
- 4- Yemen was the lowest FDI-receiving country in the MENA region.
- 5- Most of the FDI inflows were in the oil and gas sectors.
- 6- Yemen's investment climate is extremely attractive in terms of natural resources and geographical location and its possession of two important ports. However, the investment climate is directly impacted by political and security unrest due to the ongoing conflict and war, in addition to the corruption in all the government sectors, and security issues that made Yemen an undesirable destination for FDI.

- 7- Yemen severely lacks infrastructure, political and security stability, professional skill, and most importantly technological advancement.
- 8- Throughout the study, it was also discovered that, despite the departure of the majority of foreign investors who were investing in Yemen, and despite the hazardous environment, China Ports Engineering Company (CHEC) and Total Company are still operating in Yemen.

## **6 Conclusion and Recommendations**

The primary goals of the study were to describe and depict the status of FDI in Yemen and demonstrate and explain graphs and tables of the FDI inflows in Yemen. The study concluded that the volume of investments was modest and that its role in economic development was weak. This was due to the prevailing investment climate that was not ready to attract these investments, although the investment law included many advantages and exemptions granted to investment projects, and treated the foreign investor as the Yemeni investor, this law and its amendments did not lead to an increase in the volume of investments. Based on that, the researcher arrived at the following conclusion:

First, the Yemeni government struggled to improve the investment climate, as it faced many challenges. These include the low level of infrastructure and services that are necessary for the investment process, the insufficient financial capacity of the country's economy, the lack of opportunities for training and rehabilitation, and security threats due to the war.

Second, the Yemeni government attempted to rationalize the system overseeing FDI inflows during 2005-2009. Additionally, it has improved the banking system and financial sector, expanded the number of banks that provide microfinance services, encouraged private enterprises, and attracted foreign investment. However, enhancing the business climate necessitated a decrease in risk elements linked to security and political stability, but its failure in decreasing the risk was the reason Yemen attracted limited FDI compared to the MENA region.

Third, despite the concentration of foreign direct investment in the oil and gas sectors, the data demonstrated that Yemen experienced fluctuations in the inflows of investments during the study period, due to the unstable nature of the economic policy variables, which fluctuated severely.

Finally, the Yemeni economy suffered from severe economic imbalances, as it failed to attract FDI for Four years in a row. Those imbalances were caused by a group of internal and external reasons, represented in the weakness and fragility of the structure of domestic production and the structure of exports, poor management of the national

economy, poor investment environment and investment climate, and government and administrative corruption.

In addition to the above, the researcher shed light on FDI analysis during two periods of time, how the Yemeni government prepared the investment climate and laws, and how the war and corruption were key reasons to hinder more FDI inflows. So, the research recommends the following:

- 1- The rules governing vocational training must be reviewed, according to the General Investment Authority's recommendation to the relevant authorities. Additionally, in order to address the needs of the foreign investor, a productive communication channel between the foreign investor and the Ministry of Technical Education and Vocational Training must be established.
- 2- The government must enforce the new investment law in order to transition from the stage of written texts to a practical reality with honesty and integrity under the supervision of qualified authorities.
- 3- Policymakers in Yemen should stimulate an increase in GDP growth to attract more foreign direct investment. Additionally, Yemen must offer enticing packages that can encourage the investment of high-tech firms.
- 4- Providing political and security stability that stimulates investment must be a first concern, by adopting a scientific economic vision with its internal and external perspective that political parties agree on, thus adopting effective security strategies directed towards protecting the investment environment and investors.
- 5- The Yemeni government should Identify and remove the obstacles and challenges that hinder the process of increasing the GDP since doing so will have a favorable effect on the flow of FDI. Moreover, more Focus must be placed on other industries that the government has the power to support, such as services, agriculture, and fisheries, in order to improve the growth of the non-oil GDP.

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