

## POLICY ASSESSMENT AS A STRATEGY TO ENHANCE THE FOREIGN INVESTMENT IN THE KINGDOM OF BAHRAIN

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### ABSTRACT

*Bahrain has been ranked as the first place among the GCC countries for inward foreign direct investment (FDI) by at World investment report recently announce at the United Nation conference in Geneva. Bahrain is most open and liberal economy in among the GCC countries. This research has triple objectives. The first is to attempt to conduct an investigation into the policies taken by the Kingdom of Bahrain to promote its consistency in persuading and attracting foreign investment. Second is to observe the role and quality of these policies in constructing the most appropriate investment climate to attract foreign investors. The third is to identify the outcomes of the policies taken in terms of their significance to foreign investment and to the economy of the Kingdom of Bahrain. As the nature of this research and the focuses in the subjective investigation of the policies followed, a descriptive approach considered for this research with the help of another quantitative approach. Findings concluded that the policies implemented by the Kingdom of Bahrain, along with the features of its economy's characteristics were successful in attracting and persuading foreign investors and creating an appropriate investment climate. However, there are few obstacles that can be avoided by Bahrain to accomplish the perfection of a hospitable investment climate. Hence, recommendations were figured as to what adjustments could be employed to surmount these obstacles.*

**Keywords:** *obstacles, diversify, financial crisis, uncertainty*

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### INTRODUCTION

Bahrain has been ranked as the first place among the GCC countries for inward foreign direct investment (FDI) by at World investment report recently announce at the United Nation conference in Geneva. The reason for ranked as highest position by 2008 world investment report, Bahrain is most open and liberal economy in among the GCC countries. The rank based by the country received Foreign Direct Investment against the economic size. On this basis, policy assessment as a strategy to enhance the FDI in the Kingdom of Bahrain has been significant to study. Several studies have been carried out based on FDI data at the industry level. Resmini (2000) uses FDI flow data (i.e. FDI flows in US dollars in 10 CEECs in four subcategories of the manufacturing sector using the Pavitt classification; see Pavitt, 1984) over 1991-1995.

Bénassy-Quéré et al. (2007a) use FDI stock data (i.e. capital expenditures by US majority-owned affiliates) in 18 EU members for eleven industries over 1994-2002. As far as the review of literature that has been conducted revealed that there are very little number of researches in this area of study in Kingdom of Bahrain. This research has triple objectives. The first is to attempt to conduct an investigation into the policies taken by the Kingdom of Bahrain to promote its consistency in persuading and attracting foreign investment. Second is to observe the role and quality of these policies in constructing the most appropriate investment climate to attract foreign investors. The third is to identify the outcomes of the policies taken in terms of their significance to foreign investment and to the economy of the Kingdom of Bahrain.

### EMPIRICAL REVIEW

There exists a wide range of literature expressing interesting varieties of views and perspectives on the significance of investment climate in prospering growth and developments in nations' economies. However, these perspectives were never fixed rules, since the nature of the investment climate is highly dependent on the variable investment requirements.

Yeaple (2003) analyzed the role of skill endowments for the structure of US outward FDI defined in terms of the sales of U.S. multinationals' majority-owned affiliates abroad based on the benchmark survey of 1994, covering 39 countries (no CEEC) and 50 manufacturing industries. Basically, these studies confirm the traditional determinants of FDI – foremost market-related and efficiency-related location factors with respect to the first policy variable of main interest in this. Study found that an indicator reflecting a country's openness to FDI. He found that the effect of barriers to FDI is larger for vertical FDI (re-exporting) than for local market oriented FDI.

Bénassy-Quéré et al. (2007b) focused on home and host country institutional determinants of FDI on the basis of a unique database which includes firm-level data on the institutional quality. This study found that efforts towards raising the quality of institutions and making them converge towards those of source countries may help developing countries to receive more FDI. The orders of magnitude found in the paper are large, meaning that moving from a low level to a high level of institutional

quality could have as much impact as suddenly becoming a neighbor of a source country. Findings further suggested that, including institutional determinants of FDI is indeed important, in the empirical research of policy determinants.

Demekas et al. (2007) and Resmini (2000) are particularly relevant. Study concerned that the calculation of gaps among recent studies which include CEECs in an effort to estimate FDI potential. This study used FDI stocks to derive the concept of potential FDI using the actual values of exogenous variables and the best values of the policy variables. It was defined as the level of FDI predicted by the model, which is based on the actual values of exogenous variables and potential FDI calculated using the best practice policy values of policy variables. Study pointed out that their effects should be interpreted as short run effects and that the government may have limited control over some policy variables in the short term. It seems questionable that using minimum and maximum values as "best practice policy" values will reflect likely policy scenarios in a sample of heterogeneous countries, especially in the short run. A change of policy variables by a substantial amount can usually only be achieved in the medium to long run.

Resmini (2000) studied about the gap as the ratio of actual FDI flows to the fitted values from her baseline specification and distinguishes several types of industries in CEECs in 1995. The estimated gaps range from 43 percent for high-tech sectors to 88 percent in traditional sectors. This study revealed that the fitted values from her benchmark specification are used to represent FDI "potential". Yet, from a statistical point of view, the gap between this potential FDI and actual FDI values reflects that part of the model which is not explained by the variables included in the model. Thus, this gap cannot be closed by changing the policy variables included in the model.

Luiz and de Mello (2007) surveyed the latest developments in the literature on the impact of inward foreign direct investment (FDI) on growth in developing countries. FDI is thought of as a composite bundle of capital stocks, know-how, and technology, and hence its impact on growth is expected to be manifold and vary a great deal between technologically advanced and developing countries. The ultimate impact of FDI on output growth in the recipient economy depends on the scope for efficiency spillovers to domestic firms, by which FDI leads to increasing returns in domestic production, and increases in the value-added content of FDI-related production.

## **FOREIGN DIRECT INVESTMENT IN BAHRAIN**

Several studies have been conducted in several countries. For instance, Claessens, Klingebiel and Schmukler (2001) studied about FDI and Stock Market Development. Alfaro (2003) studied about FDI and Economic Growth. However, the above literature expressed varieties of views and perspectives on the significance of investment climate in prospering growth and developments in nations' economies. Bahrain ranked in first place among the GCC countries for inward foreign direct investment (FDI) by at World investment report recently announce at the United Nation conference in Geneva. The reason for ranked as highest position by 2008 world investment report, Bahrain is most open and liberal economy in among the GCC countries. The rank based by the country received Foreign Direct Investment against the economic size. The Bahrain new economic reforms the most attractive reputation in the region for foreign investment. This reform which was announced recent years have been diversifying the economy and it make road to motivate to boom the private sector. That was created best environment for international companies who looking to establish in to the GCC region. Bahrain strategic location to access to most influenced GCC countries like Saudi Arabia and Qatar with strong trade links isrooted to success with booming South Asian economy. Bahrain's policy to free and diverse the business and its society recognize as most liberal was another reason. And also it is distinctions such as these and its skilled Bahraini workforce and cost competitiveness that make Bahrain a primary destination for foreign business, foreign investment and expatriates.

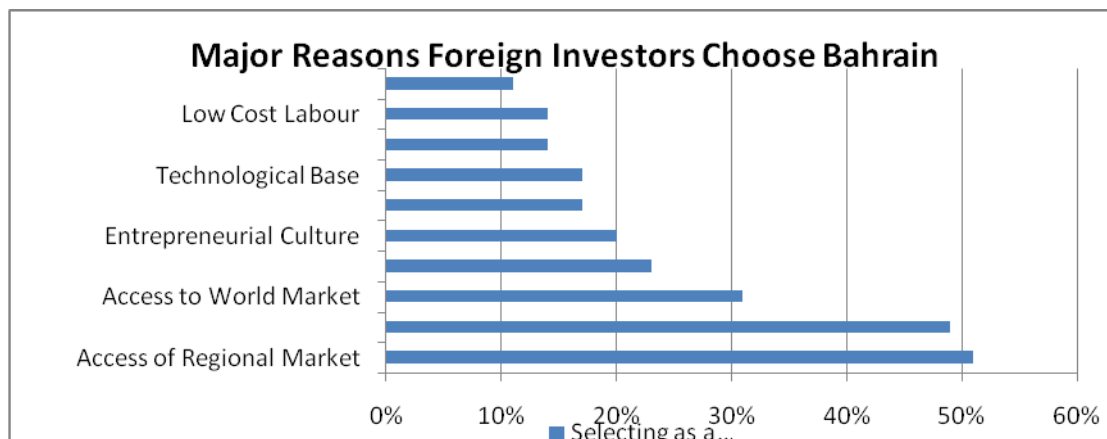
## **RESEARCH METHODOLOGY**

As the nature of this research and the focuses in the subjective investigation of the policies followed, a descriptive approach considered for this research with the help of another quantitative approach. Both enabled the researcher to get an idea of the real situation of FDI in the kingdom of Bahrain the ratios of the questionnaire are used as an indicator of the effectiveness of the policies applied to attract foreign investors. The fields of the questionnaire questions emerged from the literature, and in particular, the areas covered in the literature review, these questions were carefully chosen in order to address the real situation and the obstacles that stand behind the investment in the Kingdom of Bahrain. Simple Random sampling is used to select a group of subjects (a sample) for a study from large group (a population). In this study random sample of 200 employees in two banks and Real Estate Company, the Economic Development Board was selected for the conduction of the questionnaire. Sample answers led to draw as accurate images as possible of the role and frameworks that the kingdom of Bahrain uses to attract FDI. This study used Excel with a version of 2010 for data presentation and analysis.

## **DATA PRESENTATION AND ANALYSIS**

As the aim of this research is to analyze the policies implemented by the Kingdom of Bahrain to gain the ability to attract and embrace foreign direct investment, this has been presented and analyzed the primary data collected through the field research followed by the questionnaire conducted. The first presents an overview of the general economic policy implemented by the government and the institution and legislative structure. Subsequently, presents the results achieved through the questionnaire, in regards to the reasons that lead to the increase of Foreign Direct Investment in the kingdom of Bahrain. This is tabulated in table

**Table 1: Major reasons for foreign investors choose Bahrain**



(Source: Main Findings of a survey of FDI Enterprises in Bahrain, Jordan and Lebanon, 2001)

According to the main findings of a survey of FDI Enterprises in Bahrain, Jordan and Lebanon (2001), UN ESCWA that, higher labour costs were not affected foreign investment in Bahrain because the Bahrain had favourable environment to business as access to world market, favorable incentives, and region wise Bahrain was easy access to foreign investors due Bahrain is in the financial hub in the gulf region.

#### FDI OVER VIEW SELECTED YEARS

Further, table 2 shows the Foreign Direct Investment in Bahrain 1995 – 2012. According to the World investment report 2012 transnational corporations and the infrastructure challenge, the kingdom of Bahrain was able to increase its flows for both inward and outward FDI and passes away along period to build and grow up its economy as in 2005 the inward FDI flow was 1049 million dollars by the year 2007 it reaches 1756 million dollars which means that it increases from 39.8% to 44.7% of gross fixed capital formation but when we come to 2010 it decreases to 156 million dollars which is 2.4% because of economic crises. When we come to 2011 and 2012 it has slightly increased to 184 million dollars and 197 million dollars which are 3.8% and 3.9% respectively because of government implemented new policies against the financial economic crises.

**Table 2: Foreign Direct Investment in Bahrain 1995 - 2012**

FDI flows in millions of dollars (Bahrain)							
FDI flows	1995-2004	2005-2007	2008	2009	2010	2011	2012
<b>Inward</b>	503	1907	1794	257	156	184	197
<b>Outward</b>	273	1262	1620	1791	334	410	487
FDI percentage of fixed capital formation (Bahrain)							
FDI	1995-2004	2005-2007	2008	2009	2010	2011	2012
<b>Inward%</b>	37.3 %	22.3%	24.7%	5.0%	2.4%	3.8%	3.9%
<b>Outward</b>	20.3%	21.7%	22.4%	34.9%	5.0%	7.4%	6.7%

(Source: World investment report 2012 transnational corporations and the infrastructure challenge)

On the other side the outward FDI flows in 2005 were 1135 million dollars it increases to 1669 million dollars in 2007. And as a percentage to the gross fixed capital formation in 2005 it was 43.1% decreasing to 31% in 2006 and increasing again in the year 2007 to reach 42.5% but again when we come to 2010 we see that its only 334 which equals to 5.0% . The FDI flows increased by more than double the 1990 flows, the tables above illustrates that it has increased to 410 million dollars and 487 million dollars which are 7.4% and 6.7% respectively in the level of outward FDI in 2011 and 2012 because of instability of economic situation.

There was lower Bahrain foreign investment that flows into the sector during 2010 than 2009. In 2010, FDI in the finance sector in Bahrain was US\$ 156 million. An outward investor of Bahrain has been a significant. At the same time, outward FDI flow was US\$ 334 million in 2010. Reflecting the impact of the recent unrest on Bahrain’s finance sector the CIO’s GDP report for

the first quarter of 2011 indicated that the finance sector output in the first quarter of 2011 was 1.3% higher than the first quarter of 2010 and 0.7% higher than the fourth quarter of 2010 at real terms. Rank in the Inward Performance Index. In the 2011 report Bahrain's rank has dropped from 103 to 121 out of 141 economies in the inward performance index. This index is a ratio of kingdom's share in global FDI inflows to its share in global GDP. Details are shown in table 3.

**Table 3: Foreign Direct Investment (stock) in Bahrain 1995 - 2012**

<b>FDI Stocks in millions of dollars (Bahrain)</b>							
<b>FDI flows</b>	<b>1995</b>	<b>2000</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Inward</b>	2403	5906	14741	14998	15154	16743	17534
<b>Outward</b>	1044	1752	9340	7549	7883	8125	8568
<b>FDI Stock percentage Domestic Product (Bahrain)</b>							
<b>FDI</b>	<b>1995</b>	<b>2000</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Inward%</b>	40.%	47.4%	66.%	77.6%	66.%	69%	73%
<b>Outward%</b>	17.%	38.3%	42.%	39.1%	34.%	42%	47%

(Source: World investment report 2012 transnational corporations and the infrastructure challenge)

The analysis of empirical data of FDI stock in Bahrain during the period from 1995-2012 were fluctuating from one year to the other. The highest inward was report to start from 2008. But it has shown only slight increase up to the 2012. But in other-hand outward less fluctuation showed when it compare with inwards. This happen due to government implemented strong policy in FDI during financial crisis.

It is further discussed that 1% of the increase is found in the Bahrain stock of inward foreign direct investment in the finance sector. Similarly, compared to GDP, FDI inward stocks for Bahrain are the highest amongst Gulf countries– Bahrain is 66.9%, KSA is 39.2%, and Qatar is 24.3% UAE is 27.4%, Oman is 23.8% and Kuwait is 5%. Compared to GDP Outward stocks of the FDI are also the highest amongst GCC– Bahrain is 34.8% whereas UAE is 20%, Qatar is 19.9%, Kuwait is 14.2%, KSA is 3.9% and Oman is 3.5%.

### CROSS BORDER MERGERS AND ACQUISITIONS

The purchases of mergers and acquisitions reflect the country efforts to increase the level of FDI. the world investment report transnational corporation and infrastructure challenge shows that the purchases of mergers and acquisitions in the year 2008 was 85 million dollars compared to the sales 178 million dollars . In 2010 the sales of mergers and acquisitions were 452 millions of dollars compared to the purchases which were 190 millions of dollars. In 2011 the sales of mergers and acquisitions were 519 millions of dollars compared to the purchases which were 245 millions of dollars. In 2012 the sales of mergers and acquisitions were 575 millions of dollars compared to the purchases which were 314 millions of dollars. Over view of cross-border merger acquisition sales and purchases have slight increase from 2010 to 2012. Because of the economic crisis made slow move in business environment around the world.

**Table 4: Cross-border merger and acquisition overview (Sales and Purchase) 2005-2012 (Millions of dollars)**

<b>Sales and Purchase 2005-2012 (Millions of dollars)</b>						
<b>Year</b>	<b>2005-2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Sales</b>	45	178	187	452	519	575
<b>Purchases</b>	4	85	828	190	245	314

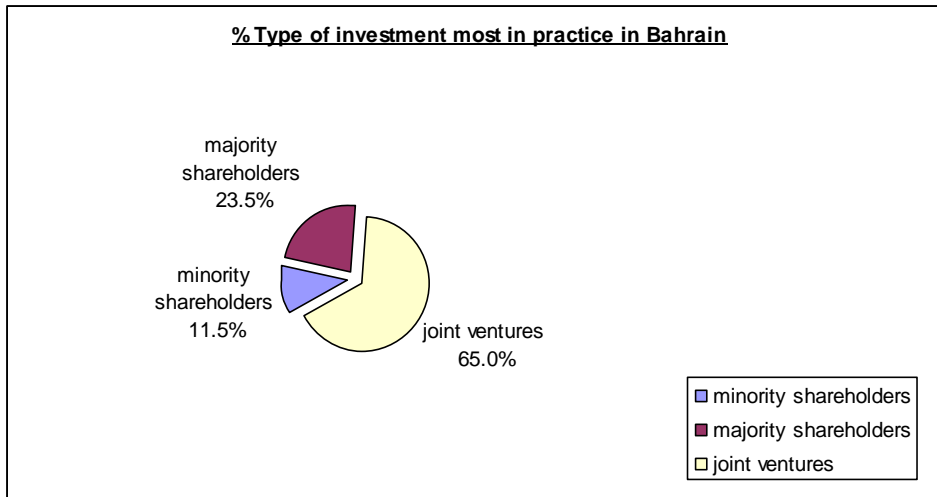
(Source: World investment report 2012 transnational corporations and the infrastructure challenge, Bahrain fact sheet)

**POLICIES OUTCOMES**

Bahrain enjoys a reputable position at the global level with respect to measures of the economic freedom and attractiveness to foreign investments. Bahrain’s progress its financial and economical openness towards foreign investment, where Bahrain was ranked first, on top of the entire MENA region (Middle East and North Africa) since the year 1995, and ranked number 12 worldwide in 2013.

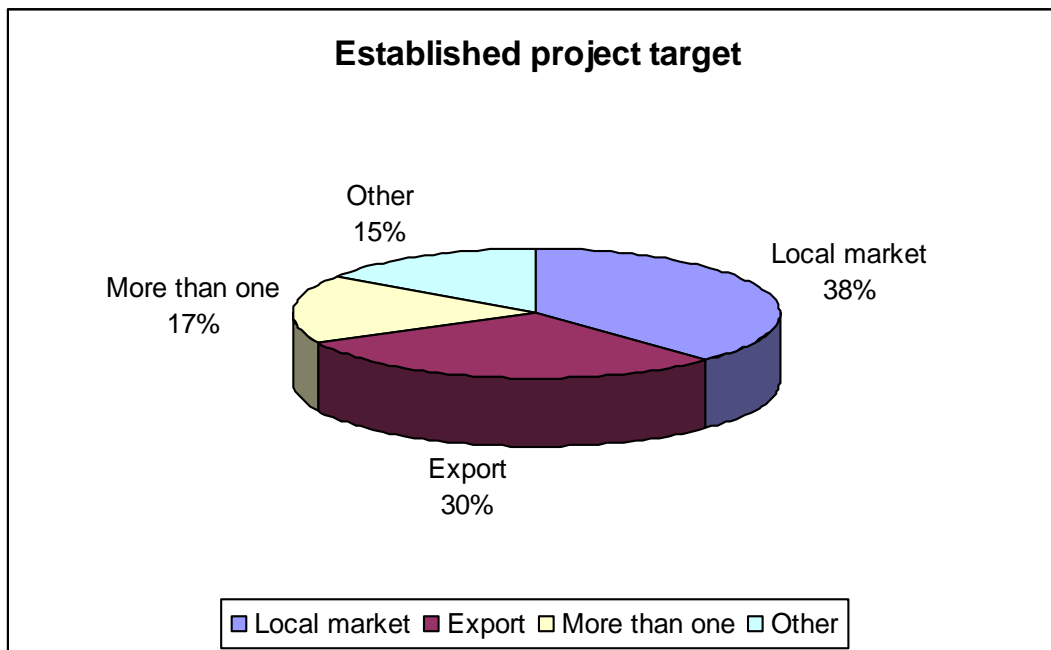
Figure 1 shows the type of investment the most practice in Bahrain. Based on the questionnaire the respondents believe that the joint ventures are the most in practice in the kingdom of Bahrain where it carries 65 % of total investment in Bahrain and 23.5% for the majority shareholders. And the least percentage is for the minority shareholders.

**Figure 1: the type of investment the most practice in Bahrain**



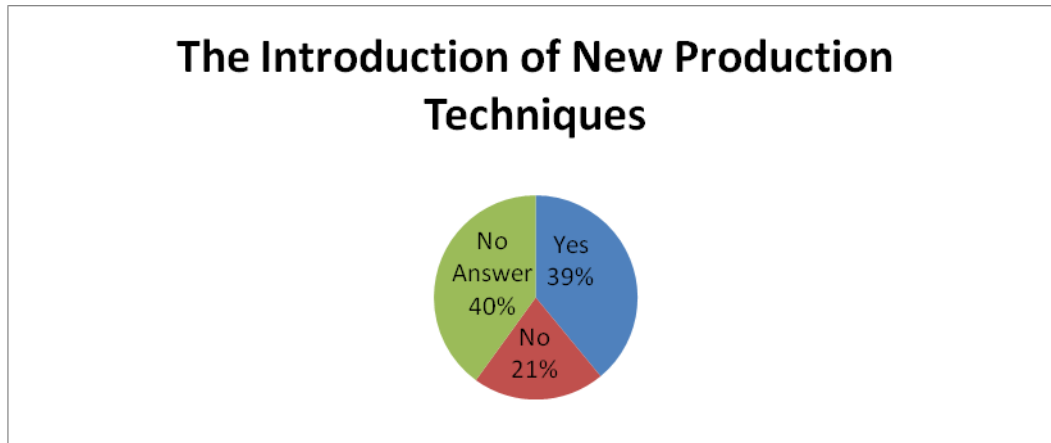
Most of the projects in Bahrain targeted for the local market which means that they are there to exploit the opportunity and fulfill a need in the market .while 30percent of the established projects for the export so for the seek of recourses available in Bahrain not else where they have chosen Bahrain . A figure of 17percent targets the local market and exports at the same time. It is shown in figure 2.

**Figure 2: The purpose of project target**



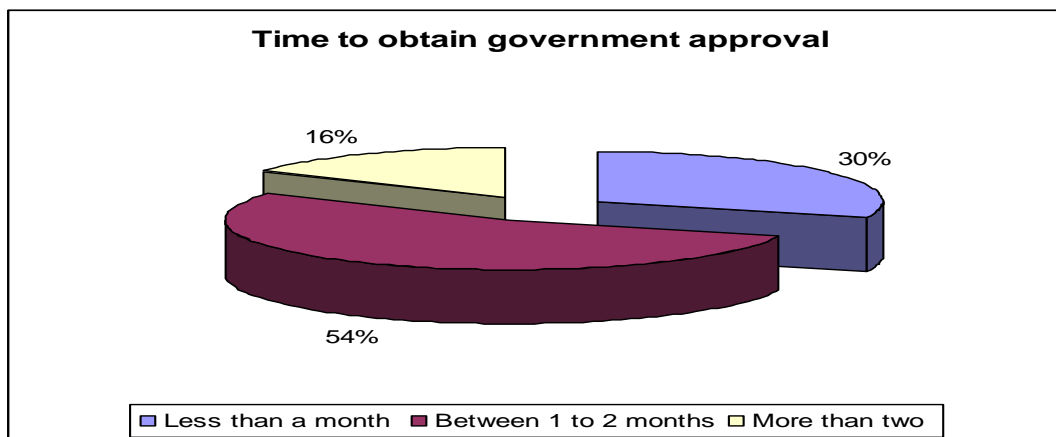
Foreign investment associated with new production techniques. From analyzing the respondents answers it seems that 40% have no answer for the question (lack of knowledge on such an issue may be a reason for this figure), while 39% agree that FDI was associated with the introduction of new production techniques. And 21% disagree that FDI was associated with introduction of new production techniques. Based on the previous figures it shows that the introduction of new techniques was not the main reason behind attracting foreign direct investment.

Figure 3: Introduction of new production techniques.



Time to obtain government approval and register a project is shown in figure 4. The time taken to obtain government approval in the kingdom of Bahrain range mostly between one to two months it acts as a barrier against the progress of attracting foreign investment in the Kingdom of Bahrain. The extensive administrative bureaucracy and corruption, can unsurprisingly worry foreign investors and make them unenthusiastic to invest in the country, the reason of these aspects of bureaucracy and corruption is triangularly shaped by three factors: superior officials having spacious powers and authorities, adjacent to the lack or shortage of the accounting system, and finally the existence of irresponsible employees' behavior.

Figure 4: Time to obtain government approval and register a project



**GENERAL POLICES PROMOTING FDI IN BAHRAIN**

According to the questionnaire 43% responded effectively that the current law in Bahrain promotes foreign direct investment while 57% responded ineffectively to the current law that promotes foreign direct investment. The investors believe that the issuance of a law regulating foreign investment which visibly specifies and identifies the scope of regulations of this type of investment, will definitely smooth and ease the effort of foreign investors at all the various stages of their investments. It is shown in table 5.

Table 5: General polices promoting FDI in Bahrain

	Effective	Ineffective
Current law promoting FDI	57%	43%
Government procedure	12%	88%

Fiscal regime	84%	16%
Overall economic policy	67%	33%
Infrastructure	98%	02%
Law on personal & intellectual property	90%	10%
Trained manpower	26%	74%

(Source: Questionnaire)

When regarding the role played by the institutional and legislative structures in regulating and attracting foreign investment, the researcher remarks that although levels of success are being pointed out, there are concerns of the roles played by the institutional and legislative structures. As for instance, the lack of a law for foreign investors is considered a vital negative influence in attracting foreign investment. Besides, the intervention of superior officials and ministries with the work of the investors effects depressingly on the facilitation and smoothness of the jobs taken. Also, the bureaucratic and corruption acts do not seem to be impressing to foreign investors willing to invest their capital in such conditions.

However, other factors taken by the institutional and legislative structures yield good impressions in terms of attracting foreign investors to the country. As with the outcomes of the policies pursued, along with the composition and roles of the legislative and institutional structures, the Kingdom of Bahrain achieved leading positions, regardless of its size. As in The Heritage report, Bahrain stands on top of its region since the year 1995 and 13<sup>th</sup> on the global level in terms of its economic and financial openness. Likewise was the World Investment report, where it was the successful in such a field, Bahrain was ranked 11th in the performance category globally. Government procedures are one of the lubricant roles in attracting foreign investors. Bahrain attempt with such role was poor, 88 % believe that government procedures were ineffective in attracting new investment. In spite of the existence of the one-stop for the smooth process of procedures of investment, the intervention of the legal official departments represents a negative barrier to the economic development, hence, a policy is to be created and pursued significantly in this field targeting assisting the progress of the investor's work.

Bahrain has an effective fiscal regime with accordance to the questionnaire. While only 16% believe that it's ineffective. The free tax environment leads to an increase in the level of foreign direct investment. It is a highly favorable tax environment with no taxes on personal or corporate income and no withholding. Based on the questionnaire 67% responded positively to the effectiveness of the overall economic policy. While 33 % of the respondents responded negatively to the effectiveness with regard to the appropriateness of overall economic policies for attracting foreign investment. When analyzing the general economic policy, the researcher significantly found out that the force of the investment and economic policy being taken by the Kingdom of Bahrain is due to its lack of large oil assets, where the government urged to sustain non-oil sectors and implement the formation of economic openness and encourage investment. This was illustrated and implemented by promoting the service sector, and namely the adoption of the financial sector, as in Figures 1 and 2. Hence, the importance of the policies along with the economic and financial developments reveal significant factors in enabling the Kingdom of Bahrain in persuading and attracting foreign investment. From the survey, it seems that the infrastructure is appropriate.

According to the questionnaire, many investors agree upon the appropriateness of the regulations and sets of law on intellectual and personal property that encourage and attract investment. The biggest barrier standing against foreign investors, according to the questionnaire was the labor law, where only 26% agreed on the availability and existence of trained labor with reasonable cost. With respect to the barriers accounting backward steps towards attracting investments, the researcher identified that the labor law implemented by the Ministry of Labor consists of a crucial barrier for investment in the Kingdom of Bahrain, where the approach pursued to implement their plan of nationalization is biased and on the cost of private sector, in addition to the country's lack of trained labor. Likewise, the lack of investment law in the Kingdom of Bahrain also generates another barrier for investment in Bahrain. Alongside, the lack of trained labor comprises another barrier in attracting foreign investment. When sketching recommendations for the Kingdom of Bahrain, the researcher utilized the barriers encountered to advice and recommend amendments and creation of laws and procedures to be made for Bahrain. Such recommendations pointed at the issuance of a new law on investment, with the aim of regulating the investor's work. Another recommendation was pointing to the provision of flexibility towards foreign skilled labor, and that the government should not impose limitations and restrictions of these employees. The author also recommended a plan for the government, to enhance its human resources, whereby correlating education system to the market to generate skilled labor.

## CONCLUSIONS

Bahrain is progressing in its strategy in creating a leading role within the regional scope in which it exists. However, there are other concerns that it should take into consideration to further enhance the progress it achieved, and be aware of the negative consequences that these concerns might represent, in other words being careful not to take two steps backwards and a step forward. When looking at the previous figures derived from the questionnaire it is clear that Bahrain has to issue a new law for foreign investment, such a law that reveals the government's intention in the field of investment. In addition, regulatory foundations should be created in favor of foreign investment, incorporating policies oriented to the facilitation and smoothness to the investors' work. Moreover, with regards to the institutional structure, there has to be significant developments to the fact of ensuring that the interests of the different bodies concerned with foreign investment do not interrupt or break in. With that in mind, it is crucially important to empower and reinforce the functionality of the Economic Development Board, and

simultaneously limit the role of the different ministries in being the destination for foreign investors in providing authorizations and permits.

Bahrain shall also provide more ranges of flexibility and elasticity with respect to foreign high skilled labor in specific areas, besides there shall be no limitations addressed by the government to the employer in the selection and employment processes of the national workers, together with the expels if they were inappropriate and incompatible with the workplace. As a final recommendation, it is crucially significant to implement a strategic policy correlating with the education system by the means of enhancing and empowering the developments and improvements of the country's human resources. The policy should further correlate with the needs of the economy where deficits in skilled labor exist, supporting the industrial, financial and tourism sectors; where there will not be any call for workers from abroad, if the government was able to provide high skilled knowledgeable workers.

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