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Relationship between Inward Investment and Productivity in Oman

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Abstract

This study explores how the peculiarity of economic structure and institutions affect the relationship between inward investment and productivity of domestic firms in Oman. It provides its analysis through an examination of the policy framework that shapes the business environment; affects the quality of institutions and proper implementation of policies targeting inward investment; and influences productivity channels and mechanisms that facilitate the transmission of spillover effects from foreign to domestic enterprises. While international business literature attributes low productivity to low absorptive capacity of local firms, this study stresses the correlation between the quality of institutions and levels of productivity. Empirical evidence collected from 96 survey questionnaires and 42 interviews with government officials and executives confirms the essential role of the state through the creation of specialized institutions and proper implementation of investment policies in facilitating the transmission of productivity spillover effects from foreign to domestic enterprises.

Keywords: Inward investment; Domestic firms; Productivity; State; Institutions; Gulf countries

Introduction

The relationship between inward investment and economic development in host countries is widely examined in literature. As explained in literature review, there are differing views on the possible effects of this type of investment on economic development. Empirical studies identified three general perspectives on the likely impact of inward investment on development: one highlights the positive impact of inward investment on development; the second underscores the negative impact of inward investment on development; and the third perspective conditions the positive impact of inward investment with certain internal policy conditions. In light of the views presented in the third perspective, one could argue that the spillover effects of inward investment do not happen automatically, but require a policy framework and channels through which spillovers can affect domestic economy or local companies.

The critical issue here is how can host country governments create and develop an appropriate policy framework and regulatory environment though which domestic economy can benefit from inward investment? Conventional views highlight the importance of government commitment and support to the business sector by developing infrastructure, creating business linkages, providing access to finance, and providing public services essential for the efficient operation of companies. Companies can also increase their productivity by upgrading production techniques, accessing advanced technology, developing operational and marketing strategies, and allocating efficiently their capital and human resources. This is a standard business practice in most developed countries, where public and private sector companies enjoy an array of supporting services from the government and operate in a healthy competitive marketplace.

However, in many developing countries such as the Arab Gulf countries, the economic structure, central planning and dominance of the public sector often limit the share of the private sector in the development process and attractiveness of these economies to inward investment. The Arab Gulf states present a special case study for a number of reasons. The first is the nature of the economic structure, where oil represents between 39 and 70 per cent of GDP, 86 per cent and 90 per cent of government revenues, and 66 per cent and 98 per cent of exports. The Gulf rentier economies are largely dominated by the public sector, while the private sector remains small and ineffective in the development process [1-3]. The second factor is that most studies conducted on inward investment in the Gulf focused on the determinants and attractiveness of the Gulf countries to foreign investmen, but there is hardly any research conducted on the impact of inward investment on the productivity spillover effects on local firms in the Gulf context. The third factor is the growing trend towards economic diversification away from oil to non-oil sectors, hence more investments are needed in sectors such as finance, services, and manufacturing. Therefore, this study adopts a multidisciplinary approach that allows for a comperhensive, indepth analysis through a case study approach, together with a combination of qualitative and quintitative techniques.

This study seeks to explore how the peculiarity of Gulf economic structure and institutions affect the relationship between inward investment and the productivity of domestic firms. It examines this relationship through three main aspects: the policy framework that shapes the business environment; the institutions and policies targeting inward investment; and productivity channels and mechanisms that facilitate spillover effects. In doing so, section two provides a theoretical perspective on inward investment and productivity spillover. Section three provides a literature review on productivity spillover channels and mechanisms. Section four examines inward investment policies and growth rates. Section five explains the methodology employed in this study and quantitative and qualitative techniques used to collect primary data. Section six provides discussions and analysis of the extent to which the three factors examined have affected the relationship between inward investment and productivity of domestic firms.

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