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Foreign Direct Investment (FDI) in OIC: Factors Influencing, Challenges and Strategies for Future

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ABSTRACT

This conceptual paper investigates into the complicated landscape of foreign direct investment (FDI) in the Organization of Islamic Cooperation (OIC) countries. Given the diverse economic, political, and social fabric of the OIC member states, FDI inflows exhibit substantial variability across these countries. We start by exposing the factors influencing FDI, ranging from macro-economic and market size, regulatory frameworks to political stability and diplomatic relations. Despite the promise held by these nations, several challenges persist. These include, but are not limited to, political unpredictability, infrastructural deficits, and sometimes, restrictive regulatory landscapes. Recognizing these barriers, the study proposes forward- looking strategies for OIC countries. Besides of barriers, some success stories were highlighted as an example of good practices. Digesting the barrier and good practices, some strategies were suggested to boost the FDI inflows into the region. Emphasis is placed on enhancing institutional quality, fostering a conducive business environment, leveraging technological advancements, and amplifying intra-OIC collaborations. The paper concludes with highlights for policy maker and investors the potential of OIC countries to attract more significant FDI by harmonizing their policies and collectively positioning themselves in the global market, while also respecting their unique cultural and socio-political contexts.

1. Introduction

Foreign direct investment (FDI) is mainly defined based on the International Monetary Fund (IMF's Balance of Payments Manual, 1993) and Organization for Economic Cooperation and Development (OECD, 1996), that is investment to obtain lasting interest by a resident entity in one country, which reflects into long-term relationship between the direct investor and the local enterprise with a significant degree of influence on management. Over the past few decades, FDI become an essential pillar supporting the structural and economic transformation of developing

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and emerging economies. This form of cross-border investment is not merely a transfer of funds; it represents a package that often includes technological spill- overs, managerial best practices, skills development, access to global markets, and further integration into global value chains [1,2]. The imperative role of FDI in fostering economic growth, employment generation, and infrastructure development in these economies cannot be overstated. It has a ripple effect: stimulating domestic industries, increasing competitiveness, and potentially leading to improved living standards [3,4].

The Organization of Islamic Cooperation (OIC) comprises a group of 57 member states, making it the second-largest intergovernmental body after the United Nations. Economically, the OIC presents a vast tapestry of nations, ranging from resource-rich countries like Saudi Arabia to densely populated nations with burgeoning markets such as Indonesia. These countries collectively have a gross domestic product (GDP) of over $6 trillion, showcasing enormous economic potential [5]. Socially, the member states, while diverse, are bound by the common thread of Islamic culture, which plays a profound role in shaping business practices, social norms, and consumer preferences. Politically, the OIC landscape is varied, with nations spanning the spectrum from monarchies to democracies, from political stability to regions of conflict, all of which have direct implications on their investment climate [6].

Given the importance of FDI for development and the unique socio-political and economic landscape of the OIC countries, understanding the dynamics, challenges, and prospects of FDI within this context becomes crucial. This research embarks on a journey to explore these aspects, aiming to provide valuable insights for stakeholders ranging from policymakers to potential investors. Hence, this study aimed to explore the historical and trend of FDI in OIC countries. Specifically, to identify the FDI influencing factors, type of challenges facing which has slowdown the nation development, sharing some success story and suggesting strategies to boost FDI in OIC countries.

2. Literature Review

2.1 Historical and Current Trends of FDI in OIC Countries

The historical trends of FDI in OIC countries can be observed from the late 20th century. During the 1980s and 1990s, the OIC countries, particularly those rich in hydrocarbons, became significant recipients of FDI, primarily in the energy sector [7]. Countries like Saudi Arabia, Nigeria, and Indonesia were pivotal destinations, predominantly due to their rich oil and natural gas reserves. However, despite these natural resources, the volume of FDI was relatively modest compared to the global FDI flows, as most of these countries had restrictive investment environments [8].

By the late 1990s and early 2000s, there was a shift in FDI patterns in OIC countries. With the initiation of liberalization reforms in various OIC nations, sectors beyond oil and gas, like telecommunications, banking, and manufacturing, began attracting foreign investors [9]. Countries like Turkey and Malaysia emerged as new FDI hubs, not due to natural resources, but because of their strategic reforms, location, and burgeoning consumer markets.

The current trend in the 21st century has seen OIC countries making consistent efforts to diversify their economies, with Vision 2030 of Saudi Arabia being a notable example [10]. As a result, several OIC countries have witnessed increased FDI flows in sectors like tourism, entertainment, renewable energy, and technology. The OIC's recent FDI trends are characterized by a notable increase in South-South investment, where OIC countries invest within the OIC bloc [11].

The UAE, for instance, has significantly increased its investments in countries like Egypt, Jordan, and Indonesia, signaling stronger intra-OIC economic ties.

Despite the positive paths, the overall FDI inflow in many OIC countries is still susceptible to global economic conditions, geopolitical tensions, and internal political dynamics. As observed, the FDI flow declined post-2015 due to low oil prices and remained subdued due to global economic uncertainties and, more recently, the COVID-19 pandemic [12]. Historically, while OIC countries have been at the receiving end of FDI mainly due to their natural resources, the current trends indicate a more diversified FDI pattern. The drives towards economic diversification, liberalization policies, and efforts to create conducive business environment have played pivotal roles in shaping the FDI landscape in these countries. However, challenges persist, and continuous efforts are required to sustain and increase FDI inflows, leveraging both their shared cultural ties and unique individual strengths.

2.2 Factors Influencing FDI in OIC Economies

There are so many factors influencing the FDI in OIC economies. Its depend on the each economic strength and uniqueness such as macroeconomic stability and market size, regulatory and institutional frameworks, natural resources available, infrastructure and technology advancement, cultural and social considerations, and the political stability and diplomatic relations of the economies. These factors were discussed as below:

i. Macro-economic stability and market size

One of the primary determinants of FDI in any country, including the OIC nations, is its macro-economic stability. Previous studies highlights that a stable economic environment, marked by controlled inflation, robust fiscal health, and a consistent growth trajectory, is enticing for foreign investors [3,13,14]. Additionally, market size and growth potential have been highlighted as significant determinants. Larger and rapidly expanding markets, like those in Turkey or Indonesia, are often more attractive to investors due to the potential for higher returns [15]. This framework is directly corresponding to the famous eclectic theory that emphasizes location (L) as one of his main pillars in the paradigm [16,17].

ii. Regulatory and institutional framework

OIC countries with a transparent, well-structured, and investor-friendly regulatory environment tend to attract more FDI. This includes ease of doing business, protection of investor rights, and the absence of excessive bureaucratic red tape [18]. Apaphara and Massawe [19], combine several conventional economic indicators with government accountability, political stability and absence of violence, government effectiveness and rule of law as their independent variables. Moreover, countries with a robust legal system and sound governance practices, ensuring the rule of law, significantly influence investor confidence [20]. The importance of rule of law in attracting FDI is all stated in new study like Shaari *et al.,* [13]. They mainly highlight political freedom and corruption as significant parts of their observations.

iii. Natural resources

Without a doubt, under the big umbrella of FDI theories assuming imperfect market, Hymer [21], for instances emphasize that location factor is an important feature for multi-national companies (MNCs) to consider upon deciding whereabouts their future long-term investment. This is again parallel to Dunning [17] and Dunning [16] in his OLI (ownership, location and internationalization) paradigm. Among the most examined feature of locational benefits are the abundance natural resources of the hosting countries. Previous studies found tendency among MNCs to dominate certain resources to maintain degrees of monopoly. For many OIC economies, especially those in the Middle East and parts of Africa, their abundance of natural resources, primarily oil and minerals, has been a significant FDI magnet [22]. The exploitation and export of these resources require substantial capital and technology, often leading to partnerships with foreign entities.

iv. Infrastructure and technological advancements

Quality infrastructure, including roads, ports, telecommunications, and energy, are crucial in determining FDI flows. Agarwal [23], observes the degree of economic development in terms of infrastructure of the host country as an influencing indicator of FDI. In more recent studies internet speed and exposure to communication devices seem to be crucial parts of variables portraying the infrastructure standard of the hosting nations. Mensah and Traore [24], for example indicate that access to high-speed internet induces FDI, particularly in the service sector. They also highlight that access to (hard) infrastructure, such as electricity and roads, amplifies the impact of internet connectivity on FDI. In 2016, Kaur *et al.,* [25], indicate that factors like railway transportation and road network as well as the quality of human resources played a crucial role in attracting FDI. Investments, especially in sectors like manufacturing, logistics, or IT services, heavily depend on the host country's infrastructure quality [26]. Additionally, countries that are open to technological advancements and integrate them into their industrial sectors become attractive FDI destinations.

v. Cultural and social considerations

Based on the industrial organization hypothesis (IOH), cultural differences between the investing companies of their origin and the hosting nations are considered market imperfections. This trait could be both positively and negatively affecting FDI inflow. The understanding of the term culture is not limited to simply working habits of philosophy but also cultural inheritance of the locals. The cultural fabric, rooted predominantly in Islamic traditions and values, plays a role in influencing FDI in OIC countries. While this shared cultural identity can create a sense of familiarity and trust among investors from fellow OIC nations, it can sometimes be perceived as restrictive, especially when it comes to sectors like entertainment, finance, or consumer goods [27]. Nadia and Phuc [28], specify that establishment of UNESCO heritage sites, as an appreciation for high values of cultural inheritance along with domestic tourism demand are leading factors of tourism FDI.

vi. Political stability and diplomatic relations

Investors tend to be risk-averse, making political stability a primary consideration. Countries with consistent and transparent political systems, free from conflicts and upheavals, naturally attract more FDI [29]. Moreover, diplomatic relations between OIC countries and potential investor nations can also have a significant impact on investment flows. While OIC economies share common cultural and religious ties, the FDI inflow determinants vary significantly across members due to differences in economic stature, political stability, and resource endowment. Nevertheless, some overarching themes, like regulatory quality, economic stability, and infrastructure quality, remain universally relevant. For OIC economies to optimize their FDI potential, it's imperative to understand and address these multifaceted determinants holistically. Political stability and diplomatic relations are considered as non-economic or specifically non-traditional variables.

Therefore, these strategic factors should be strengthened and emphasis further in order to attract significant FDI to OIC countries which will lead to rising in national productivity and economic growth.

2.3 Existing Challenges Faced by OIC Countries in Attracting FDI

Success is not come easily. There are many challenges need to be faced by OIC countries in attracting FDI. Among the obvious factors are political instability, regulatory barriers and bureaucracy, infrastructure deficit, socio-cultural barriers, limited skilled labor force and perceived security concern.

i. Political instability

One of the paramount concerns raised in the literature about FDI inflow in OIC countries is political instability. Nations that are prone to frequent changes in leadership, internal conflicts, or civil unrest naturally deter foreign investors due to heightened risks [18]. The political landscape, especially in parts of the Middle East and certain African OIC countries, has often been cited as volatile, presenting unpredictable investment scenarios.

ii. Regulatory barriers and bureaucracy

The ease of doing business in many OIC countries is hampered by regulatory barriers and bureaucratic red tape. Numerous studies have highlighted the cumbersome processes, lack of transparency, and inconsistent regulations as significant hindrances to FDI inflows in these nations [14].

iii. Infrastructure deficit

Despite being rich in natural resources, several OIC countries still lag in terms of quality infrastructure. Inadequate transportation networks, energy supply issues, and limited technological infrastructure can be deterrents for investors, particularly those looking to set up manufacturing or services units [26].

iv. Socio-cultural barriers

The strong socio-cultural fabric, predominantly Islamic, in OIC countries can sometimes be perceived as a challenge by foreign investors. Restrictions in sectors like finance, which avoid interest-based operations due to Sharia law, or cultural norms influencing consumer behavior, can pose unique challenges [27].

v. Limited skilled labor force

While OIC countries have a vast pool of labor, there is often a mismatch in terms of skills required by foreign investors and what's available locally. The lack of highly skilled labor in areas like technology, research, and advanced manufacturing can impede FDI inflow [30].

vi. Perceived security concerns

The perception of security risks is it from terrorism, geopolitical tensions, or internal strife, has been highlighted in literature as a significant challenge for many OIC countries. These perceptions, sometimes even if they are not the ground reality, can sway investor sentiment negatively [11]. While the potential for FDI in OIC countries is vast, given their combined market size, strategic locations, and abundant resources, these challenges have historically posed significant barriers. Addressing these issues requires a multipronged approach, combining economic reforms with broader socio-political strategies to foster a more conducive environment for foreign investments.

These factors need to be addressed seriously by all the OIC economies since it is able to distract foreign investors' interest to invest. However, some members have successfully attracted the FDI to their countries and its can be a good practice to follow.

3. Some Success Stories

OIC (Organization of Islamic Cooperation) countries have witnessed several success stories in terms of attracting Foreign Direct Investment (FDI) as shown in Table 1. Since most of the OIC countries are in developing countries, FDI has become one of the approaches that can be used to increase the economic growth. The following section will discuss some of the suggestions.

Table 1
Success stories of OIC countries in attracting FDI

United Arab Emirates (Dubai)	• Dubai's Transition: Historically reliant on oil, Dubai successfully transitioned into a diversified economy with a focus on tourism, aviation, real estate, and finance [31]. • Free Zones: Establishing free zones like the Jebel Ali Free Zone (JAFZA) and Dubai Multi Commodities Centre (DMCC) attracted a plethora of businesses due to tax benefits, 100% foreign ownership, and world-class infrastructure. • Expo 2020: The event has attracted billions in FDI, reinforcing Dubai's reputation as a global hub.
Malaysia	• Manufacturing and Electronics: The Penang region transformed into a hub for electronics manufacturing, with firms like Intel, AMD, and Dell setting up facilities there [32]. • Islamic Finance: Malaysia has established itself as a global leader in Islamic finance, attracting significant FDI into its banking sector [33].
Turkey	• Strategic Location: Leveraging its position between Europe and Asia, Turkey attracted FDI in sectors ranging from automotive to energy. Companies like Ford, Toyota, and Huawei have significant investments in the country [34]. • Renewable Energy: The country's emphasis on clean energy solutions has drawn investments from global players in the wind and solar energy sectors.
Indonesia	• Consumer Market: As the world's fourth most populous country, its vast consumer market has attracted FDI in sectors like automotive, FMCG, and e-commerce. Giants like Unilever and Toyota have extensive operations in Indonesia [35]. • Digital Boom: With the rise of digital start-ups like Gojek and Tokopedia, Indonesia has seen increased FDI in its tech sector.
Qatar	• Liquefied Natural Gas (LNG): Qatar capitalized on its vast natural gas reserves to become the world's largest LNG exporter, attracting significant FDI in the process [36]. • 2022 FIFA World Cup: Infrastructure developments and preparations for the event have led to increased FDI in construction, tourism, and related sectors.
Egypt	• Suez Canal Corridor: The expansion of the Suez Canal and development projects around it have drawn substantial FDI, capitalizing on its strategic significance for global trade [37]. • Renewable Energy: The Benban Solar Park, one of the world's largest, has attracted international investors, showcasing Egypt's renewable energy potential.

4. Suggested Strategies to Boost FDI in OIC Countries

Table 2 shows some forward-looking strategies that OIC (Organization of Islamic Cooperation) countries might consider enhancing their FDI attractiveness.

Table 2
Forward-looking strategies implement by OIC countries in enhancing FDI

Digital transformation and e-governance	Embracing digital platforms can make bureaucratic processes more efficient, transparent, and user-friendly. Digitalization, especially areas like business registration, licensing, and land acquisition, can significantly reduce the time and cost of setting up businesses [38].
Strengthening regional cooperation	Enhancing intra-OIC trade and investment can be pivotal. Regional collaborations, like the establishment of OIC Free Trade Zones or investment corridors, can foster greater FDI within member states [39].
Investment in education and skill development	To meet the demands of the modern economy, OIC countries should prioritize investments in education, emphasizing STEM (science, technology, engineering, and mathematics), to produce a highly skilled workforce attractive to foreign investors [40].
Enhanced dispute resolution mechanisms	Establishing credible, efficient, and independent legal and dispute resolution systems can boost investor confidence by ensuring that any conflicts will be handled fairly and

	expeditiously [41].
Green and sustainable investment	With global emphasis on sustainability, OIC countries can position themselves as hubs for green investments by offering incentives for renewable energy projects, sustainable agriculture, and green tech innovations [42].
Sector-specific incentives	Tailoring incentives, like tax breaks or research grants, to high-priority sectors can draw targeted FDI. For instance, promoting sectors like Halal tourism, fintech tailored to Islamic finance, or agribusiness can be lucrative [33].
Promotion of start-ups and innovation hubs	Establishing and promoting innovation hubs and start-up ecosystems can attract FDI in the technology and innovation sectors. Countries like Jordan have witnessed success with initiatives like the "Start-up Jordan" program [43].
Strengthening bilateral and multilateral ties	Expanding and deepening diplomatic ties can lead to more comprehensive trade agreements and investment treaties, facilitating easier FDI flows [44].

5. Conclusion

The landscape of Foreign Direct Investment (FDI) in OIC (Organization of Islamic Cooperation) countries presents a mosaic of unique opportunities, challenges, and evolving dynamics. Historically centered on resource extraction, especially in hydrocarbon-rich nations, the path of FDI in the region has witnessed commendable diversification, encompassing sectors such as tourism, technology, and real estate. Yet, this journey hasn't been without hurdles. Political instabilities, regulatory complexities, and infrastructural deficits have often posed challenges to the FDI influx.

However, the resilience and adaptability of OIC countries have been evident through numerous success stories. As a result of Dubai's transformation, Malaysia's leadership in Islamic finance, Turkey's strategic utilization of the geolocation and Egypt's developmental strategies around the Suez Canal stand as testament to the potential and aspirations of these nations. Policymakers in OIC countries have continually striven to create conducive environment for foreign investments through initiatives like Special Economic Zones, tax incentives, and regulatory reforms. Their efforts underscore recognition of FDI's significance in spurring economic growth, diversification, and global integration.

For investors, the OIC region offers a spectrum of opportunities. From the vast consumer markets of Indonesia to the tech start-ups of Jordan and the energy reserves of Qatar, the potential is both diverse and substantial. However, it demands wise understanding of the local cultural, socio-political, and economic landscapes. This research has not only illustrated the factors influencing FDI in OIC countries but also highlighted the inherent challenges and evolving strategies. As the global economic paradigm continues to shift, it becomes necessity for OIC nations to adapt, innovate, and collaborate. Future research undertakings, as suggested, can further deepen our understanding, providing more nuanced and actionable insights.

In the needle point of global FDI, OIC countries possess a distinctive attraction, one that's rooted in their rich cultural heritage, strategic geolocations, and a shared vision for progress and prosperity. Their journey, though marked by challenges, holds the promise of a future satisfied with opportunities and collaborative growth. This conclusion aims to condense the essence of the research, reflecting on the past, assessing the present, and looking optimistically towards the future of FDI in OIC countries.

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