Brandeis University
Crown Center for Middle East Studies
Crown Paper 1 June 2008

Managing the Oil Wealth

Foreign Assets of GCC Countries

Nader Habibi

Crown Papers

About the Crown Paper Series

These article-length monographs provide a platform for the Crown Center's research staff and faculty to publish their long-term research in a peer-reviewed format. This publication series succeeds the Center's earlier *Working Papers* and aims to showcase the scholarship of the Center's postdoctoral fellows, faculty, and Research Fellows. The opinions and findings expressed in these papers are those of the authors exclusively, and do not reflect the official positions or policies of the Crown Center for Middle East Studies or Brandeis University.

Acknowledgement

The Crown Center for Middle East Studies expresses its gratitude to the Leir Charitable Foundations for funding Dr. Nader Habibi's position, thus allowing the research and writing of this paper.

Table of Contents

Introduction*

The global financial community has always been interested in how the oil-exporting countries manage their oil wealth, but this attention has intensified since 2002 as a result of the sharp increase in the price of oil. The unprecedented increase in the oil revenues of the major oil exporters has left them with very large quantities of hard currency, which they have eventually transformed into other financial or physical assets. As a result of these large revenues, several oil-exporting countries—including Russia, Saudi Arabia, the United Arab Emirates, and Norway—have emerged as important players in international capital markets. The magnitude of the oil-exporting countries' funds available for investment is so large that not only investment bankers, but Western governments and international financial agencies such as the International Monetary Fund and the World Bank, are interested in how these countries are investing their oil revenues.

What matters from the point of view of governments and international agencies is that the flow of these revenues into various geographical markets and asset types could have a strong impact on relative asset prices and interest rates. If too many investors from oil-exporting countries show interest in the investment assets in a specific region or country, the prices of those assets might rise too fast and cause excessive volatility in capital markets. Furthermore, if a sudden decline in the price of oil forces these countries to repatriate a portion of their foreign investments over a short period of time, this sudden liquidation could also lead to volatility in the international asset markets and precipitate financial panics similar to the 1997 Asian financial

* I have received valuable comments on an earlier draft of this article from Massimiliano Castelli, Mohammed Samhouri, Eckart Woertz, and two anonymous referees.

crisis. In addition to these economic concerns, governments are also worried about the political and national security implications of rising foreign ownership in some industries.

This article focuses on the foreign investments of a select group of oil-exporting countries that are collectively known as the Gulf Cooperation Council (GCC). The GCC is made up of six small oil-rich Arab countries in the Arabian Peninsula: Saudi Arabia, the United Arab Emirates, Kuwait, Oman, Bahrain, and Qatar.[1] The main objectives of this study are: a) to offer a detailed overview of the size of GCC foreign assets, and of their allocation among various geographical regions and asset types; b) to evaluate the economic and financial consequences, for the respective host countries and for global capital markets, of the investment of GCC foreign assets; and c) to assess the potential strategic as well as economic benefits for GCC countries of these large foreign asset portfolios.

GCC purchases of U.S. government bonds and treasury bills help finance the large fiscal deficit of the United States and contribute to the stability of the U.S. dollar.

In comparison with other oil-exporting countries of the Middle East and North Africa, the GCC states have earned substantially larger oil and gas revenues relative to their import needs in recent years. Consequently, their foreign asset accumulations have been far more substantial than those of mid-size oil-exporting countries such as Iran, Algeria, and Venezuela. Furthermore, the GCC states are expected to generate large current account surpluses in the coming years as well. As a result, their total foreign assets, which are already significant at nearly $1,500 billion, will likely increase to at least $2,800 billion by 2012.

The large current account surpluses of GCC countries have coincided with large external trade deficits run by the United States. These sizeable annual deficits have weakened the U.S. dollar in recent years, but their impact has been partially offset by large investments on the part of Asian and oil-exporting countries in U.S. asset markets. The GCC countries do not release any data about the size and composition of their foreign assets, but financial experts believe that they regularly purchase large amounts of U.S. government securities—a claim supported by U.S. Treasury statistics on purchases of these securities by oil-exporting countries. Without these purchases, the decline of the dollar against other major currencies would have been even larger.

Like China, then, the GCC countries own a substantial amount of U.S. securities, either directly or indirectly. It is also worth noting that since China invests a large portion of its external account surplus in U.S. treasury bills, GCC investments in China will indirectly contribute to additional demand for U.S. government securities by China.[2] Understanding how GCC governments as well as private investors manage their foreign assets will therefore contribute to a better understanding of how they impact global financial and asset markets.

The foreign assets of GCC states are also worth analyzing because of their internal significance for these countries' economies and their potential impact on the rest of the Middle East. The GCC countries have taken bold steps toward economic liberalization in recent years, and these steps have resulted in the unprecedented growth of their capital markets. As a result, domestic investment opportunities in these countries have sharply increased, and a portion of their oil surplus revenues is being invested within the GCC. The domestic economies of GCC countries, however, cannot absorb all of the oil revenues that these countries are currently earning. The increased volume of fiscal spending and private investment has already led to a rise in inflation rates in these countries, and the injection of additional funds into any of their domestic economies over a short time span could result in overheating and macroeconomic instability.[3]

If GCC countries inject all of their oil revenues into their domestic economies over a short period of time, it could lead to inflation and macroeconomic instability.

Furthermore, the economic reforms instituted by GCC countries have also led to larger inflows of foreign investment, and that uptrend is expected to continue. The injection of foreign investment will further increase inflationary pressures, and some GCC governments will have to reduce their own domestic investments in order to ease inflation-related risks.[4] Hence, by investing a portion of their oil surpluses abroad, the GCC countries can achieve more macroeconomic stability at home. The GCC governments have also used a portion of their oil revenue surplus to reduce their foreign and domestic debt to very low levels.

Another benefit of foreign investment for GCC investors is that it helps them reduce their exposure to the political and economic risks of their domestic asset markets. In an environment that is vulnerable to political and security risks, investors have a strong incentive to complement their domestic investments with foreign investments. Thus, Kuwait's large foreign assets came in very handy when its leadership had to establish a government in exile during the Iraqi occupation of that country in the second half of 1990. Another benefit of maintaining a pool of foreign assets is that GCC states can use those assets to finance potential current account deficits that can arise from unexpected downturns in the price of oil or unforeseen sharp increases in government expenditures. Furthermore, these assets, if properly invested, can generate for GCC countries a substantial amount of investment income to accrue alongside their oil export revenues. For some countries, such as Kuwait, investment income revenues are already substantial: They amounted to 24% of oil revenues in 2006.

By investing a portion of their foreign assets in other Arab countries, the GCC countries can also contribute to the economic growth of the entire region. There is no doubt that the stability of GCC countries is closely linked to the stability and economic prosperity of other Arab countries. Several Middle Eastern countries have undertaken economic reforms in the past two decades and have been able to attract large amounts of GCC investment in recent years—and the GCC countries are expected to increase their investments in other Arab countries, for both economic and political reasons. To date a large share of GCC investment in the rest of the Arab world has gone into real estate and tourism facilities, and these investments have created thousands of new jobs.

GCC investments in other Arab countries will contribute to growth and stability in the entire Middle East.

In the following sections, we offer an assessment of the size of GCC foreign assets, along with projections for their growth over the next five years. The allocation of these investments among various types of financial and physical assets is then discussed, followed by a review of significant equity acquisitions in major geographical regions. Throughout, we analyze the political and strategic considerations that affect GCC investors' preferences for various geographical areas.

Size of GCC Foreign Assets

Oil-exporting countries, as we have observed, do not generally report detailed and accurate statistics on the size and composition of their foreign investments. This is partly due to the lack of comprehensive data on private-sector holdings of foreign assets. It is common for wealthy investors and rich citizens in developing countries to hold a portion of their wealth overseas so as to safeguard it against domestic political and economic risks. In countries where corruption is prevalent, high-level public-sector officials routinely transfer a portion of their illegal earnings overseas to avoid detection. (Thus the popularity of secret Swiss bank accounts among public officials.)

Most oil-exporting countries also withhold information about their state-owned foreign assets, which are commonly controlled by their central banks or by government-owned investment funds.[5] A notable exception is Norway, which reports detailed statistics about its state oil fund. There are more data available about the foreign asset holdings of commercial banks through the Bank for International Settlements (BIS), but they cover only a portion of each country's total foreign assets.

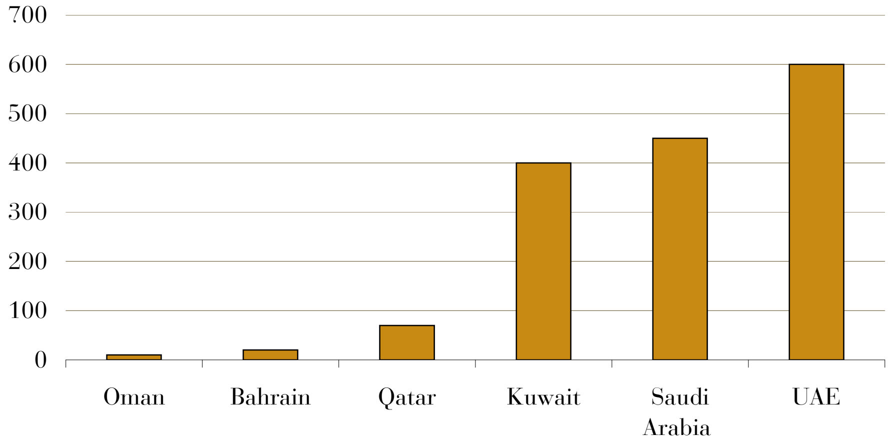
In the absence of reliable formal data, investigators have tried to assess the foreign assets of oil-exporting countries through indirect methods. One common one is to use the available data on current account balances (CAB) as proxies for the net flow of funds into and out of foreign asset holdings on an annual basis.[6] The underlying logic behind this procedure is that when a country enjoys a current account surplus in a particular year, the net value of its foreign assets will increase by the amount of the surplus. In recent years, several investigators have used this indirect method to estimate the foreign assets of GCC countries.[7]

Nearly 98% of GCC foreign assets in 2006 belonged to the United Arab Emirates, Saudi Arabia, Kuwait, and Qatar.

In response to strong interest on the part of financial institutions, the Institute of International Finance (IIF) conducted an analysis of GCC foreign assets in the first half of 2007.[8] Assuming that GCC foreign assets prior to 1971 were negligible owing to the low price of oil, IIF estimated the total foreign assets of each GCC country by adding their current account surpluses and applying a 7% reinvestment rate over the period 1971–2006. (Another reason for choosing 1971 as the starting point for these calculations was that the United Arab Emirates, Qatar, and Bahrain were established as independent nations in that year, and hence no balance of payment data are available for those countries from earlier years.)

Chart 1 shows the IIF estimates of GCC countries' foreign assets as of December 2006. While the accumulated assets of Oman ($10 billion) and Bahrain ($20 billion) were negligible, reflecting these countries' small oil assets, those of the remaining four GCC members were substantial: The combined foreign assets of the United Arab Emirates, Saudi Arabia, Kuwait, and Qatar accounted for 98% of the GCC's total assets of $1,550 billion in 2006. Bahrain's oil production is negligible, and Oman's output has steadily declined in recent years, from a peak of 1.03 millions of barrels per day (mb/d) in November 2000 to 0.72 mb/d in February 2007—and further declines are expected in the next few years. Bahrain's foreign asset data are also affected by its offshore banking position. During the 1980s and 1990s, Bahrain served as an offshore banking center for GCC countries, although its dominance in that regard has recently been challenged by Dubai. While the foreign assets of Bahrain's offshore banking sector are substantial, they are mostly offset by its large liabilities.

Chart 1. Total Foreign Assets of GCC Countries, December 2006
(in billions of dollars)



Source: Institute of International Finance, May 2007.

An alternative estimate of GCC foreign assets was reported by Lane and Milesi-Ferretti (2006), but their data set ended in 2004.[9] After revising their 2004 estimates based on the latest available economic statistics for GCC countries, I extended their data up to 2006. The Lane/Milesi-Ferretti data, as thereby modified, show the value of GCC assets at the end of 2004 to be $800.13 billion. For two GCC countries, Bahrain and Kuwait, I was able to find 2005–6 data for capital outflows into various types of foreign assets: foreign direct investment (FDI), portfolio-debt assets, and foreign currency reserves. I used these flow data and a 7% reinvestment rate to extend each asset type's estimated value up to 2006. Then, by aggregating the values of these three components, I arrived at estimates for the total value of foreign assets in 2005 and 2006. (See Table 1.) For the remaining four GCC countries, I used the current account surplus method, which was explained earlier, to estimate the 2005 and 2006 value of foreign assets.

Table 1. Foreign Assets of GCC Countries, 2003–6 (in billions of dollars)

Country	Estimated by	2003	2004	2005	2006
Bahrain	Author*	91.51	107.27	133.94	185.12
	Lane & Milesi-Ferretti(L&M-F)	91.51	107.27		
Kuwait	Author	117.49	138.85	184.26	257.27
	L&M-F	117.49	138.85		
Oman	Author	9.86	11.48	15.03	28.17
	L&M-F	9.00	9.63		
Qatar	Author	72.19	84.80	101.44	114.64
	L&M-F	72.19	82.36		
Saudi Arabia	Author	170.74	234.62	341.03	374.74
	L&M-F	170.74	222.21		
UAE	Author	198.61	223.11	263.20	316.02
	L&M-F	198.61	241.09		
GCC Total	Author	660.41	800.13	1,038.91	1,275.97
	L&M-F	659.54	801.40		

* Starting with the 2003 and 2004 estimates of Lane and Milesi-Ferretti (2006), I have extended their data up to 2006. Whenever data were available, I followed their methodology and extended the data for components of foreign assets in their data set. Where data for components were not available, I used the current account surplus as an aggregate proxy for capital outflows. For some countries I have also re-estimated the figures for 2004, but the differences with Lane and Milesi-Ferretti's data are small.

Several differences between the IIF estimates and my estimates of GCC foreign assets are worth emphasizing. First, my 2006 estimate of total GCC assets ($1,276 billion) is $274 billion smaller than the IIF estimate. This is due to the low value of Lane and Milesi-Ferretti's estimates for 2004, which limits the growth rate for 2005 and 2006 under my methodology. The estimates for the UAE, in particular, seem to underestimate the actual size of the relevant foreign assets; some financial experts believe that the UAE's foreign assets were close to $600 billion in 2006. Second, Bahrain's foreign assets are significantly larger in my estimate ($185 billion, versus the IIF estimate of $20 billion). The source of funding for these investments however, is the country's offshore banking system rather than petrodollars. Bahrain's oil export revenues are very small, and its annual oil revenue savings are even smaller. On the other hand, my estimate for UAE assets is much *smaller* than the IIF estimate ($316 billion versus $600 billion).[10]

GCC Foreign Assets and Investment: Growth Projections for the Next Five Years

The size of GCC foreign assets is certain to grow significantly in the next few years. The strong global demand for oil and natural gas products will continue, and should support a price of oil above $60 per barrel for several years. Based on this projection, GCC countries can look forward to substantial oil revenues in the near term. Although the strong economic growth momentum of recent years will increase the volume of imports, the import bill will still remain below export revenues, which will result in current account surpluses over the next five years. Even using very conservative projections for oil production levels, the GCC states' collective external surplus (excluding investment income) is likely to exceed $150 billion per year through 2012.

Contrary to most energy experts' expectations, the price of crude oil rose by an additional 10% in 2007, after growing by more than 235% in the years 2003–6. The average price of crude oil (WTI) rose from $65.90 per barrel in 2006 to $72.30 per barrel in 2007. In light of these record high oil prices, we estimate that the current account surplus of GCC countries in 2007 was $200 billion. Although oil prices have remained high in the first three months of 2008, I use highly conservative price projections for oil prices to estimate the current income surpluses of GCC countries up to 2012. Assuming that the price of oil will hover in the $65–$80 per barrel range during the next five years and that the value of GCC imports will grow by an average of 7% to 10% per year over that period, the GCC current account balance will decline to $180 billion in 2008, and then to $150 billion over the succeeding four years.[11] These surpluses will add an additional $980 billion to GCC foreign assets during 2007–12, as demonstrated in Table 2.

Table 2. Projected Growth of GCC Assets, 2007–12

Year	GCC foreign assets at start of the year (in billions of dollars)	Rate of return on total asset portfolio (%)	Investment income (in billions of dollars)	Additional investment from CAB surplus (in billions of dollars)
2007	1,550.0	7	108.5	200
2008	1,815.1	7	127.1	180
2009	2,071.3	7	145.0	150
2010	2,308.3	7	150.0	150
2011	2,548.4	7	178.4	150
2012	2,805.4	7	196.4	150

Note: Assets value at the beginning of 2007 was as reported by IIF. Figures for other years are Author's calculations. Assets estimates are based on the assumption that 50% of investment income will be reinvested.

The GCC countries that are currently flush with liquidity are also likely to reinvest a large portion of the investment income that their foreign assets generate each year. Under the highly conservative assumption that only 50% of investment income will be reinvested, these countries will reinvest an additional $65 billion in 2007, and this amount will grow to $118 billion by 2012. (In estimating reinvestment income, I have assumed a conservative average rate of return of 7% per year on existing GCC foreign assets.)

Based on the total amount of additional investment projected during the next five years, the total foreign assets of GCC countries are expected to exceed $2,800 billion by 2012, and to generate approximately $196 billion in investment income in that year. (See Table 2.) This will be a significant source of income for GCC countries and will complement their ongoing energy export revenues. Based on recent estimates by the consulting firm Global Insight, the merchandise export earnings of GCC countries amounted to $477 billion in 2006. Under the conservative assumption that these export earnings will grow

Investment of additional oil surpluses and reinvestment of the investment income on existing foreign assets will increase GCC assets to $2,800 billion by 2012.

by 5% per year, GCC export earnings will rise to $639 billion by 2012. Based on this projection, the investment income earnings of GCC countries ($196 billion) will be equivalent to 31% of their merchandise export earnings in 2012.

Allocation of GCC Foreign Assets

Lack of official and transparent data on GCC foreign assets makes it very difficult to analyze the internal allocation of these assets. Some information is available, however, through international organizations and Western government agencies that keep track of the flow of investments into major financial markets. Based on data from these sources, investigators have been able to develop a picture of how GCC countries invested the current account surpluses they earned during 2002–6. The May 2007 study by IIF relied on three sources to generate this information: 1) the U.S. Treasury International Capital System, which provides data on investment flows into the United States; 2) the Bank for International Settlements, which reports the foreign assets of reporting banks vis-à-vis individual countries; and 3) Bloomberg's database on mergers and acquisitions, which keeps track of major equity purchases and foreign direct investments. The findings from the IIF study appear in Table 3, below.

Table 3. Accumulation of Additional Foreign Assets by GCC Countries, 2002–6

Additions to official hard currency reserves	$32 billion
Identified investment (invested in Western countries)	259
Unidentified investment	251
Total accumulation	542

Source: Institute of International Finance, May 2007.

Although the current account surpluses of GCC countries amounted to $542 billion during the years 2002–6, the combined records of the three sources mentioned above show $259 billion worth of foreign investment originating from GCC countries. These countries have added an additional $32 billion to their international hard currency reserves. These figures still leave $251 billion worth of foreign investment that remains unidentified. It is very likely that a large portion of these unidentified funds are invested in the United States and Europe through custodial accounts and financial intermediaries.

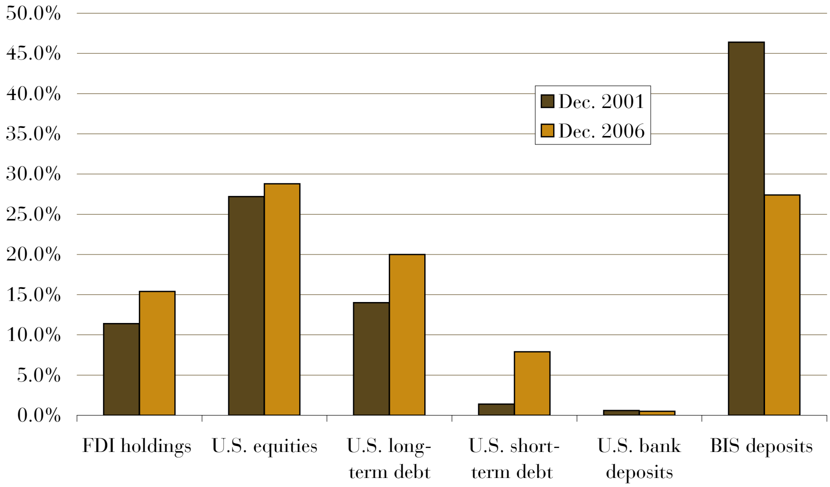
GCC investors often use United Kingdom–based financial intermediaries to purchase U.S. securities anonymously. A recent study by Toloui (2007) has observed a positive correlation between the cumulative current account surplus of oil-exporting countries and purchases of U.S. securities by UK residents and institutions.[12] Toloui believes that this correlation constitutes circumstantial evidence that UK institutions regularly buy U.S. securities for their Arab clients, who wish to remain anonymous. After the September 11, 2001, terrorist attacks, Arab governments and private investors became more cautious about investing in the United States and Europe; they were worried that in the event of another major terrorist attack, Western governments might freeze (or, in rare instances, seize) the assets of Middle Eastern investors. These concerns encouraged some Arab investors to reduce their visible investments in the United States—and, to a lesser extent, in other Western countries—by concealing their holdings through European intermediaries and custodial accounts.

Some GCC investors purchase U.S. securities through intermediaries in the UK in order to remain anonymous.

The available data on the identified portion of GCC investments during 2002–6 ($259 billion) allow for a comparison of GCC net foreign assets in December of 2001 and December of 2006. The IIF study of 2007 estimates that the value of GCC's identified net foreign investments rose from $176 billion in December 2001 to $434 billion by December 2006. The relative shares of different types of assets are shown in Chart 2. The data reveal that GCC countries have maintained a larger share of their identifiable foreign assets in foreign direct investment and U.S. financial securities, while their bank deposits worldwide have diminished significantly. This shift grows out of these countries' growing preference for long-term assets that offer a higher return than is available from savings deposits. It also is a reflection of the large increase in the foreign assets of GCC governments in comparison with their need for cash and bank deposits. Bank deposits offer a smaller return compared with U.S. government bonds and treasury notes, which are equally safe.

Deposits in international banks accounted for more than 45% of GCC foreign assets in December 2001, as compared with 27% in December 2006. The shift from bank deposits to equity and bonds is partly a reflection of the growing role of state-owned investment funds (also known as Sovereign Wealth Funds, or SWFs) in the management of GCC governments' foreign assets. All GCC countries with the exception of Saudi Arabia have transferred the management of their oil wealth from their central banks to their respective SWFs, which have invested these funds with longer-term investment goals—typically, in higher-yielding debt and equity assets. (And Saudi Arabia is in the process of creating an SWF for this purpose.) Another possible explanation is that GCC countries maintain a large share of their liquid bank deposits in third-party custodial accounts so as to minimize the political risks that were mentioned earlier.

Chart 2. GCC Net Foreign Assets
(Identified Portion)



Source: Institute of International Finance, May 2007.

The unidentified portion of GCC countries' foreign investments ($251 billion) is harder to analyze. Based on the IIF (2007) and Toloui (2007) studies, a large portion of these investments is most likely still allocated to the mature markets of North America and Europe through European intermediaries—and is primarily invested in U.S. government securities and sophisticated financial derivatives. The IIF study concludes that total GCC investment in the U.S. during 2002–6 was approximately $300 billion, which was significantly larger than the identified amount. While media reports of GCC investment in Asia and other emerging markets point to a clear increase in the flow of equity capital and FDI to these markets, their relative size to total investment is still small. The IIF study indicates that GCC countries together invested $60 billion each in Asia and the Middle East—the equivalent of 22% of the total foreign investments of all GCC countries during 2002–6. Most of these investments took place in 2005 and 2006, as both sides showed interest in an expansion of economic and political ties. As will be explained in the next section, GCC investors consider Asian countries more suitable for long-term equity investment. At the same time, however, the market capitalization of most Asian markets is much smaller than mature Western markets.

The Geographical Distribution of GCC Foreign Assets

The geographical distribution of GCC foreign assets is affected by both economic and strategic factors. Management of the Sovereign Wealth Funds of GCC countries, in particular, will require several strategic considerations that make the process more complicated than is the case with respect to private investment funds. The complications arise from the fact that the diplomatic and economic relationships between Arab countries and the rest of the world will affect the scope of available investment opportunities and the political risks incurred when investing in various parts of the world. A major terror incident, for example, in a Western country involving the nationals of a GCC country could result in a temporary suspension of financial activities between that country and GCC countries, with an adverse effect on the profitability of GCC investments.

There is also a growing skepticism in many countries about the large foreign investments by public enterprises and by the SWFs of other countries[13]—a suspicion rooted in fears that these investment funds might be used by the foreign governments that own them for political and strategic goals rather than in the service of purely economic and commercial objectives.[14] There is also a growing concern that since these SWFs control large quantities of financial capital, their attempts to transfer funds across countries and markets could result in excessive financial volatility. In response to these concerns, the United States has recently revised the guidelines for the Committee on Foreign Investment in the United States (CFIUS), which enjoys oversight power regarding foreign investment flows into this country. Several European countries, including Germany, are also introducing new regulations to increase the monitoring and regulation of SWF investments in their economies.

There was a noticeable shift from bank deposits to equity assets in GCC countries' foreign portfolios during 2002–6.

Such uncoordinated regulations, however, could result in protectionist barriers against foreign investment, thereby reducing the liquidity and efficiency of global capital markets. The Sovereign Wealth Funds will be forced to allocate a large share of their capital to fixed income assets (i.e., government bonds), or to transfer them to emerging markets which, in general, impose fewer restrictions on SWFs. In order to avoid such adverse developments while at the same time addressing the concerns of host countries with regard to SWF investments, several experts have called for international coordination and development of new standards for the operation of SWFs. Edwin Truman, for example, has called for the development of international standards to create more transparency with respect to the objectives and management of SWFs—and he believes that the World Bank and the IMF can play a constructive role in the development of such standards.[15] Until such multilateral standards are established, SWFs are vulnerable to arbitrary regulations and will have to take such regulations into account in their asset management strategies.

In general, a typical institutional investor makes its foreign investment decisions on the basis of two categories of risk parameters in a potential host country: economic and political. The economic risks depend on macroeconomic conditions, the regulatory environment, and supply-and-demand forces in the industry under consideration. The political risks depend on such factors as the country's level of political stability and degree of corruption, the establishment of the rule of law, respect for property rights, and the host government's attitude toward SWFs. Both private and state-owned investment funds in GCC countries must deal with these risk factors; but when investing in Western countries they must also take into account several diplomatic risk factors arising from Western countries' sensitivities about terrorism and the potential for unexpected deterioration in relations between Arab and Western countries. Some of these risks are:

In addition to domestic political and economic risk factors, GCC investors must also take diplomatic risks into account in their investment strategies.

a) adverse diplomatic developments leading to the confiscation or freezing of assets by the host government. In response to a major terrorist attack, for example, involving the citizens of an Arab country (a particular danger in the case of GCC member states),[16] the United States might freeze the financial assets of that country, or confiscate them in order to compensate the victims.

b) a negative media campaign or consumer boycott aimed at the investments of a GCC country. Even without any hostile action by the host government, the GCC investments in a country can fall victim to a negative media campaign, resulting in loss of demand and reduced profitability. Or a GCC-owned bank or entertainment center in Europe or the United States might face a consumer boycott as a result of an unexpected rise in anti-Arab sentiments.

c) a host government's preventing the purchase of a firm by a GCC buyer or limiting the investment to a minority holding for national security reasons. An example was U.S. pressure on Dubai Ports World to sell off its American port management assets in 2006.

d) a heavy regulatory burden, imposed as a result of national security considerations. Financial transactions between the home office of a GCC firm and its foreign branches, for example, might become subject to very restrictive and time-consuming controls, which could have an adverse effect on the efficiency and profitability of operations.

e) the victims of a terrorist incident filing legal suits to demand financial compensation from a GCC government with asset holdings in the United States or other Western countries.

Relevant diplomatic factors are not limited to the risks listed above, however. In some cases, diplomatic considerations might encourage *more* investment in a specific country. Political control over a Sovereign Wealth Fund allows a GCC government to manipulate it for political or diplomatic purposes: Thus, if a GCC government seeks diplomatic support from a particular country with respect to an issue of interest to the Arab world, it might instruct its SWF to increase its investment in that country as a gesture of goodwill. (Contrariwise, if diplomatic tensions develop between a GCC government and a host country, that government might instruct its SWF to reduce its asset holdings in that country.) And it is believed that some GCC countries hold large amounts of U.S. government bonds because of those countries' special strategic relationships with the United States. These types of politically motivated portfolio adjustments, however, should have little influence on long-term equity investments. Indeed, one can argue that any increase in long-term equity investments will create an incentive for the investing country and the host country to preserve their diplomatic relations and avoid diplomatic tensions.

We anticipate that the allocation of GCC foreign assets among various regions of the world will depend on how investors and asset managers weigh the return potential of each investment opportunity against these three types of risk factors: the economic, the political, and the diplomatic. Table 4 offers an investment risk profile for major regions. It also includes IIF estimates of how GCC countries allocated their foreign investments during 2002–6 among these regions. Both Europe and the United States offer low economic and political risks for foreign investors because of their political stability and well-functioning economic institutions—but GCC investments face a higher diplomatic risk in the United States relative to Europe.

Occasionally, the treatment of Muslim immigrants in Europe and a perceived disrespect for Islamic cultural symbols may lead to anger in Arab countries, but it is unlikely that this will cause any long-term damage to the trade and investment relations between Europe and Arab countries. Another potential source of diplomatic risk for GCC investments in Europe is American economic and political influence in Europe. When the United States asks European governments and financial institutions for cooperation with respect to the prevention and detection of financial support for terrorism, it generally receives it. Consequently, the same diplomatic risks that confront GCC assets in the United States might also be present in Europe, albeit to a lesser extent.

Arab governments have experienced very little diplomatic tension with Asian countries in recent times—and the economic environment of these countries has been very attractive to foreign investors over the past decade. In response to the 1997 financial crisis, Asian governments have taken several positive steps to increase the stability of their financial institutions. The political institutions in some of these countries, however, are still problematic. Corruption and red tape, for example, are evident in several Asian countries, including China.

Table 4. Investment Risk Profiles of Various Regions for GCC Investors

	GCC Investment Risk Factors			
	Economic Risks	(Domestic) Political Risks	Diplomatic Risks	Estimated GCC Investment 2002–6 (in billions of dollars)*
United States	Low	Low	High	300
China/Advanced Asian countries	Low	Medium	Low	60
Europe	Low	Low	Medium	100
Emerging markets	Medium	Medium	Low	22
Arab countries	Medium	High	Medium	60

* Source: Estimates as reported by the Institute of International Finance, May 2007.

Investment in emerging markets in Central Asia, Russia, South Asia, parts of Africa and the Middle East entail medium levels of economic and political risk because of the domestic condition of these countries, but the diplomatic risks for GCC countries are low. Among emerging markets, GCC countries enjoy a special relationship with other Arab countries. A high degree of cultural, religious, and linguistic similarities bond the Arab world together; these common cultural values and the relative ease of travel create added incentive for GCC private investors to invest in other Arab countries. Many Arab countries lag behind other emerging market areas, however, in terms of competitiveness and the creation of investment-friendly business environments. Still, historical experience has shown that GCC investors have increased their investments in Arab countries that have implemented substantial economic and financial reforms.[17] In particular, Egypt, Tunisia, Morocco, Jordan, and Lebanon (prior to the 2006 Hezbollah-Israel war) have seen sharp increases in GCC investments in recent years. Egypt, in particular, has been a strong beneficiary of investments both by private citizens of GCC countries and, more recently, by institutional investors. Saudi citizens in the Hijaz region (which is close to Egypt), for example, tend to invest in Egypt because of historical tribal and family ties. Many private Kuwaiti citizens also maintain residential homes in Egypt.

In general, for many small- and medium-sized GCC private investors unfamiliar with global investment opportunities, stable Arab countries offer an attractive and nearby alternative—and Arab countries that have undergone recent legal reforms and privatization drives have attracted a number of large GCC firms. These investments face a moderate level of diplomatic risk, which in Arab countries is closely related to regime stability. If a moderate Arab regime is replaced with a radical government, the risk of nationalization of GCC investments is likely to increase. Nevertheless, on the whole the risk factors remain moderate, and GCC investments in other Arab countries are expected to increase, although most will flow to a small group of countries that have been successful in terms of economic reform.[18]

GCC Investments in the United States

While the September 11th terrorist attacks increased the political and diplomatic risks attending Arab investments in the United States, both the GCC countries and the United States have strong economic incentives to increase the flow of GCC investments into the U.S. Attracting foreign investment is essential for the United States, which is consistently running very large trade deficits. For GCC investors, the U.S. represents the largest financial market in the world—and U.S. financial securities, in particular, represent a low-risk and highly liquid class of financial assets. The strength of the U.S. economy and its financial markets in the 1980s and 1990s led to a substantial amount of GCC investment in both government securities and private assets.

It is difficult to obtain accurate statistics on GCC investments in the United States, because neither party is interested in releasing the relevant statistics. The U.S. departments of Treasury and Commerce keep track of foreign investments in the United States, but they do not release foreign investment data for individual GCC countries. Instead they release a single aggregate figure for "Middle East Oil Exporters," which includes the GCC countries, Libya, and Algeria. The U.S. government justifies the nondisclosure of country-specific foreign investment data for this group of nations on national security grounds. However, it is likely that the U.S. withholds this data at the request of some GCC countries which do not want the details of their investments in the United States to be available to the public.

The U.S. government collects detailed data on the government security holdings and FDI investments of GCC countries in the United States but does not release this information to the public.

The investment figures in Table 4 show that, according to the IIF, GCC countries invested 55% of their current account surpluses during 2002-6 in U.S.-based assets, while only 18% was invested in Europe. Based on these figures, then, it must be concluded that diplomatic risks have not deterred GCC investors from investing in U.S. government securities. News reports and several other pieces of data, however, suggest that foreign direct investment and acquisition of physical assets have been more sensitive to U.S.-Arab relations and other political risks.[19] The evidence suggests that although Arab countries might have reduced their holdings of visible equity assets in the United States, their investments in less visible assets such as government bonds remain substantial, and most of them might be held in offshore accounts in London and other European capitals.

Some experts have speculated that after September 11th, Arab investors withdrew a substantial amount of their investments from the United States. In August 21, 2002, the *Financial Times* reported that Saudi investors had withdrawn as much as $200 billion worth of their financial assets from the United States after the attacks. (The *Financial Times*' claim, however, was strongly refuted on August 22nd by the Saudi billionaire Prince Alwaleed in an interview with the BBC.[20]) This report was published only six days after 600 relatives of the September 11th victims filed a large lawsuit against several Saudi citizens and organizations for their alleged financial support of al-Qaeda.

This lawsuit was subsequently blocked by the Bush administration on national security grounds.

Security concerns and anti-Arab sentiments in the United States have posed a new challenge for GCC investors after 2001: identifying politically "safe" investment opportunities. Visible Arab investments in some industries can lead to strong public opposition. In 2006, the strong opposition to Dubai Ports World's (DPW) control over operations at several U.S. ports finally forced DPW to sell its U.S. assets.[21] Arab investors now are careful about investing in U.S. firms when that might arouse similar opposition. In a March 2007 interview with Reuters, Attif Abdulmalik, chief executive of Arcapita, which invests Arab funds in the United States, mentioned that he generally avoids politically sensitive projects in the U.S.[22] Overall, the investors and asset managers who handle GCC funds take the danger of political backlash into account when evaluating various types of equity and FDI investment opportunities in the United States.

Several other parameters may also be discouraging GCC investment in the United States. Since the September 11th attacks, obtaining a U.S. travel visa has become more difficult for Arab businessmen, and security background checks often take several weeks. Air travel to the United States after obtaining a visa has also become more difficult owing to security concerns. There is also a fear among Arab visitors that they might face ethnic harassment or discrimination in the U.S. Since direct investment in the United States will require some employees of the host company to travel to the U.S., these travel and visitation difficulties might act as disincentives—and these concerns might encourage Arab investors to allocate more of their U.S. assets to minority equity stakes and financial securities.

GCC interest in U.S. securities has continued despite increasing diplomatic tensions after the September 11th terrorist attacks and Arab opposition to the U.S. invasion of Iraq.

While fear of litigation and of asset freezing may have led to withdrawal of Arab funds from U.S. markets in the months immediately after the September 11th attacks, it is commonly believed that in more recent years such fears have impacted the internal allocation of GCC investments among various types of U.S.-based assets rather than discouraging such investment altogether. GCC investors have searched for "safe" assets, such as real estate, particularly tourist facilities; small- to medium-sized financial firms; and retail consumer businesses. Foreign direct investment is only a small portion of GCC investment in the United States, but it is on the rise (although it is not increasing as fast as GCC investment in Asia). Data for specific GCC countries are not available, but Middle East FDI in U.S. businesses rose by 608%, from $1.73 billion in 2003 to $12.24 billion in 2006.[23] This is a small amount compared with European investment in the U.S. ($110 billion in 2006), but it was larger than the FDI inflows from Canada or Latin America. The growth rate of Middle East FDI in 2003–6 was larger than in any other region, and most of it originated in GCC countries.

Some GCC investors and policy makers believe that expansion of trade and investment ties with the United States will give them more influence over U.S. Middle East policy.

So far I have argued that high diplomatic risks have had a negative impact on GCC investment in the United States. It must be added, however, that for some GCC investors, political considerations might have the opposite effect and encourage *more* investment. Some Arab leaders believe that they can have more influence on U.S. policy in the Middle East if they increase their economic engagement with the United States. This possibility has created an incentive for some Arab businessmen and political leaders to encourage more investment in both directions. In a 2006 television interview, the head of the UAE-based Emaar real estate development company expressed the opinion that the expansion of trade and investment ties between GCC countries and the United States would create a strong incentive for the U.S. government to resolve the Arab-Israeli conflict and thereby create a more stable environment in the region. Policy makers in some other GCC countries also believe that their rising economic value to the United States will allow them to influence American Middle East policy.[24]

In the second half of 2007, as increasing incidents of real estate mortgage default deepened the financial crisis in the United States, several GCC Sovereign Wealth Funds seized the opportunity to invest in troubled financial institutions and banks. Citigroup, which had suffered substantial losses as a result of the housing crisis, received a $7.5 billion investment from the Abu Dhabi Investment Authority. In January 2008, Merrill Lynch, which had also suffered heavy losses for the same reason, received a $6.6 billion investment from a small group of investors, including the Kuwait Investment Authority.[25] These large-scale investments have resulted in an intense media debate in the United States regarding the political and national security implications of large investments by SWFs, particularly those owned by Middle Eastern governments.

As mentioned earlier, the United States is currently reviewing its regulations on large investments by SWFs. This review is mostly a result of the Foreign

Investment and National Security Act (FINSA), which was approved by the U.S. Congress in June 2007 and signed into law in July. FINSA was introduced primarily in response to the 2006 controversy regarding the purchase of several American port management authorities by Dubai Ports World. It requires the U.S. government to enhance its evaluation of foreign investments and of mergers with and takeovers by foreign firms, particularly SWFs. It is yet to be seen how the U.S. government will react to these visible equity investments in major financial institutions by GCC-based SWFs. It should be pointed out that U.S. concern is not limited to GCC-based funds; large SWFs in Russia, China, and other Asian countries are also showing a growing interest in U.S. equity investments.

GCC Sovereign Wealth Funds are investing in American financial firms that have suffered losses as a result of the sub-prime lending crisis.

The GCC Sovereign Wealth Funds view distressed U.S. financial institutions as sound long-term investments. Unless the U.S. government blocks these investments under FINSA regulations, the infusion of GCC money into U.S. financial institutions may be substantial during 2008. While the primary motive for these investments is long-term economic gain, these investments will make a positive contribution to U.S. financial stability by providing much-needed liquidity and helping many institutions remain solvent; they will also deepen the financial and economic interdependency between the GCC and the United States. To the extent that this growing interdependency increases the U.S. commitment to the security of GCC countries and compels future American governments to pay more attention to GCC political demands, it will be welcomed by GCC governments. These governments are also actively encouraging U.S.-based financial firms to invest in their own countries. Both Citigroup and Merrill Lynch are currently active in this regard.

Table 5. The United States: Recent FDI and Equity Investments by GCC Countries

Bahrain	Arcapita is a Bahrain-based investment firm that purchases real estate and equity assets in the United States; the U.S. office of Arcapita is situated in Atlanta. In 2006, Arcapita created an Islamic investment fund with a focus on U.S.-based assets. It has successfully acquired several firms in recent years, including Caribou Coffee, Church's Chicken, Small Document Solutions, Forba Holdings, Bijoux Terner, Meridian Surgical Partners, and 3PD.
Bahrain	Bahrain-based Investcorp has invested in several famous retail stores, including Saks, Tiffany, and Gucci. Other investments in the U.S. include the Circle K convenience store chain and the auto parts company CSK. Investcorp generally targets ailing companies that it believes can be turned around.
Qatar	In November 2006, Qatar Telecom purchased a 38% stake in NavLink, a U.S.-based subsidiary of AT&T. NavLink maintains an active presence in the Middle East telecommunications and data management market.
Saudi Arabia	The best-known individual Arab investor in the United States is Prince Alwaleed bin Talal, who is a member of the Saudi royal family. In the 1990s he acquired a minority holding in Citigroup; he is currently a major shareholder, with a 3.9% stake. Prince Alwaleed's investment firm (Kingdom Holdings) has made significant equity investments in Hewlett-Packard, Apple Computer, and EBAY.
Saudi Arabia	Saudi Basic Industries Corporation (SABIC) purchased GE Plastics for $11.6 billion in May 2007; this deal was successful and did not raise any political opposition. SABIC manages its North American assets through its subsidiary SABIC Americas, which is based in Houston, Texas.
Saudi Arabia	The state-owned Saudi oil company Aramco owns an equity interest in three large refineries in the United States. Aramco operates these refineries in partnership with Royal Dutch/Shell. Aramco and Royal Dutch/Shell expanded their U.S. asset holdings in 2002 when they purchased the shares of Texaco in Motiva Enterprises to become the joint owners of Motiva, which owns three refineries and supplies gasoline to 7,600 Shell gasoline stations in the eastern and southern United States.

UAE	Dubai Investment Group acquired the Essex House Hotel in New York City in September 2005. The purchase was praised by New York City officials and labor unions, as the Dubai Investment Group pledged to invest $50 million for various renovation projects. The sales value was not disclosed, but earlier in 2005 another potential buyer had offered $400 million for this hotel.
UAE	Dubai International Capital (DIC) purchased the British firm Duncaster Group in May 2006. The firm, which manufactures precision parts with military applications, has two major plants in Connecticut and Georgia. The $1.2 billion deal attracted the attention of the United States government but was ultimately approved. DIC also acquired a 2% stake in DaimlerChrysler, worth $1 billion, in 2005.
UAE	In June 2007, the Dubai-based Istithmar investment company announced that it had signed a definitive agreement to purchase the Barneys New York retail chain for $825 million. The deal is expected to gain regulatory approval. Barneys operates upscale stores in several metropolitan U.S. cities.
UAE	In August 2007, Dubai World announced that it was negotiating a $5.2 billion investment in MGM Mirage. The deal will also give Dubai World a 50% share in a major MGM development project in Las Vegas.

GCC Investments in Asia

Several recent media interviews with GCC investors and policy makers indicate that GCC countries are highly interested in equity and direct investment opportunities in East Asia. (The initial agreements on several investment projects have already been announced, but very few investments have become operational yet.) There are several factors behind this development. First, Asian economies have enjoyed rapid growth, and most Asian countries have been successful in developing a business-friendly environment. Second, Asian countries have never had any diplomatic tensions with GCC countries or with the Arab world in general.[26] Consequently, as shown in Table 4, GCC investments in Asian countries face smaller diplomatic risks in comparison with those posed by the United States. Third, India and China are fast emerging as two of the largest buyers of GCC crude oil, and GCC governments are investing in the oil sectors of these countries in order to further solidify their long-term energy ties with them.[27] By investing in the refineries and petrochemical units of their Asian oil clients, GCC countries can also capture a share of the downstream market for refined oil products in these countries. As a result, a significant portion of GCC investments in Asia have been directed to oil-related industries like refineries and petrochemical plants, as shown in Table 6 below. These energy investments have mostly originated from Saudi Arabia and Kuwait.

The IIF data (Table 4 on p. 16) show that only 11% of GCC foreign investments in 2002–6 were allocated to Asia. Although GCC investment in Asia, based on IIF estimates, is significantly smaller than that in the United States, the gap is much smaller when we focus on direct investment in hard assets and joint ventures. As was mentioned earlier, a large portion of GCC investment in the United States is placed in U.S. government bonds and treasury bills, whereas equity and direct investment dominate GCC investments in Asia.

The absence of diplomatic tensions between Asia and Arab world, as well as growing Asian demand for GCC oil, will encourage more GCC investment in Asia.

Looking at the table below of recent GCC investments in Asia, it is noticeable that most GCC acquisitions are concentrated in China, India, Malaysia, and Indonesia. Japan has surprisingly not caught the attention of GCC investors in recent years, despite having attracted a large amount of GCC investments in previous years.[28] China, on the other hand, is receiving a substantial portion of GCC's ongoing investments in Asia. The largest GCC economy, Saudi Arabia, has been eager to expand its trade and investment ties with China. Saudi ruler King Abdullah visited China in January 2006, when preliminary talks were held on Saudi investments in China's oil and petrochemical sector. These eventually led to several investment agreements in 2006–7 for joint ventures between the Saudi oil company Aramco and various Chinese state-owned oil companies. The Saudi Basic Industries Corporation (SABIC) is also involved in a joint partnership with Chinese firms with respect to investment in a petrochemical plant.[29]

China has welcomed these projects because they lead to a long-term energy relationship with Saudi Arabia. Having invested large amounts in China's downstream oil sector, Saudi Arabia will have a strong incentive to supply crude oil to that country. However, as indicated in Table 6 below, Saudi investments in China are not limited to the oil sector; additional investments in tourism and light manufacturing are also underway. Within Asia, China's largest competitor for trade and investment with GCC countries is India—which, like China, is growing highly dependent on Middle East oil. It is no wonder that immediately after visiting China, King Abdullah visited India and was received warmly.

GCC investors are also investing in Pakistan, Malaysia, and Indonesia—these investments are being encouraged in part by common Islamic values, and in particular by the opportunities they afford for the application of Islamic modes of finance. These three countries are predominantly Muslim, and while Pakistan has converted its entire banking industry into an Islamic banking system, Malaysia has developed an active Islamic banking branch within its conventional banking system. The Islamic banking institutions of Kuwait and Bahrain have invested in joint partnerships with Islamic banking institutions in Malaysia and Indonesia.

The predominantly Muslim countries of Asia are taking advantage of Islamic financial instruments to attract GCC investments.

Some highly religious investors in GCC countries shy away from ordinary banks because of Islamic opposition to charging interest. In response to the financial needs of these types of investors, many Islamic banks and Islamic investment funds have been created in GCC countries in the past three decades. These institutions have shown a strong interest in investment opportunities in other Muslim countries, particularly in Asia. Kuwait Finance House, which is a leading Islamic financial institution in the Middle East, agreed in 2007 to invest in Malaysia's multibillion-dollar Iskandar development project; it has also invested in Malaysia's fourth largest bank, RHB Capital. The Kuwait Finance House managers have announced that once they acquire a majority stake in RHB, they plan to convert it into an Islamic Bank.[30] In recent years, the development of the Islamic bond market (commonly referred to as Islamic Sukuk) in Bahrain, Indonesia, and Malaysia has also helped raise a considerable amount of money for Islamic investment funds. The Indonesian government is also trying to raise funds (in both domestic and GCC markets) for public projects by issuing Sukuk bonds.[31]

Table 6. Asia: Recent FDI and Equity Investments by GCC Countries

Bahrain	On July 19, 2007, the Bahrain-based Gulf Investment House announced the signing of an agreement with Sinhe City officials in China to construct a mixed commercial/residential complex near Beijing. The project, called Energy City China, is worth up to $5 billion dollars and will cover an area approximately 13.4 square kilometers large, situated 30 kilometers from Beijing. The complex will serve as a business hub for international and Chinese oil companies and is expected to encourage additional Arab investment in China and to boost the volume of Sino-Arab trade, which has grown rapidly in recent years. Once completed, Energy City China will include an international mercantile exchange for energy-related products and a Sino-Arab international business school.
Kuwait	The Kuwait Investment Authority invested $720 million in China's largest commercial bank, ICBC, during its IPO in September 2006, thereby becoming the largest subscriber to its initial share offering; ICBC is currently worth more than $800 billion. At the same time, the Qatar Investment Authority purchased $206 million worth of ICBC shares.
Kuwait	Kuwait Finance House established a subsidiary in Malaysia, Kuwait Finance House Malaysia (KFHM), in February 2006 to supervise its investments in that country and in other ASEAN nations. KFHM has the Al-Nibras Islamic Real Estate Fund to attract GCC funds for its investment projects. In July 2007 the Al-Nibras Fund, in partnership with another Islamic fund, invested $280 million in Keppel Bay waterfront properties. KFHM is also investing in several health care projects in Asia through its recent partnership with Singapore-based Pacific Healthcare.
Kuwait	In early 2006, Kuwait Petroleum and a petrochemical subsidiary of the Chinese oil company Sinopec signed a joint venture to build a $5 billion oil refinery and petrochemical complex in China's Guangdong Province. This project, which received final approval from the Chinese government in July 2006, is currently the largest joint project in China's petrochemical industry and is expected to become operational in 2010, with an annual refining capacity of 15 million tons.

Kuwait and the UAE	In August 2007, three GCC firms and one Jordanian firm signed an agreement with the Iskandar Development Region authority in Malaysia for an initial investment of $1.2 billion. The participating firms are Aldar Properties (UAE), Mubadala Development (UAE), Kuwait Finance House (Kuwait), and Millennium Development International (Jordan). The project will require at least $10 billion worth of total investment in the next few years, and more GCC investment is expected in its latter phases.
Qatar	In May 2007, Qatar Telecom and the Saudi firm A.A. Turki Corporation, Trading and Contracting (ATCO), purchased a 75% stake in Burraq Telecom Limited of Pakistan for $12.8 million. Qatar Telecom also formed a partnership with Singapore Technologies Telemedia (ST Telemedia) by purchasing a 25% share in Asia Mobile Holdings (AMH). ST Telemedia maintains a 75% controlling stake in AMH. Asia Mobile Holdings has sizeable stakes in several telecom firms in Singapore, Indonesia, Cambodia, and Laos. Through AMH, Qatar Telecom will be able to expand its investments in Asia.
Saudi Arabia	The Saudi-based garment firm Alaajlan & Bros announced in July 2007 that it would invest $50 million in a cotton spinning plant in China's Xinjiang Uygur Autonomous Region. This firm's existing investments in China are worth $200 million.
Saudi Arabia	The Saudi Arabian oil company Aramco, in partnership with ExxonMobil, has signed a contract to invest $3.5 billion in an oil refinery project in China's Fujian Province. This refinery is expected to have a capacity of 240,000 barrels per day when completed in early 2009. The Aramco-Exxon partnership has also signed a separate contract with Sinopec to operate a network of delivery terminals along with 750 gasoline stations in Fujian.
Saudi Arabia	In May 2007, the Saudi Basic Industries Corporation (SABIC) and China's state-owned oil company, Sinopec, signed an agreement for a $1 billion investment in a petrochemical plant in northern China. The project cost will be divided equally between the two companies. This agreement requires final approval by the Chinese government.

Saudi Arabia	Kingdom Hotel Investments, a subsidiary of the Saudi-based Kingdom Holdings, purchased an 81.9% share in the Four Seasons Hotel in Jakarta in July 2007. It had previously purchased a Swissotel in Kunshan, China, in April 2007, and had taken over the Canada-based Four Seasons Hotel Chain in 2006, in partnership with Bill Gates. Other Asian hotel assets are located in Malaysia and Cambodia. Kingdom Hotel Investments plans to raise more than $100 million through debt financing to enable the acquisition of additional hospitality assets in Asia.
Saudi Arabia	In June 2007, Saudi Telecom announced that it had agreed to purchase a 51% stake in the Malaysian telecommunications firm Maxis Communications which has large operations in Malaysia, Indonesia, and India. The Saudi government ended Saudi Telecom's monopoly on landline service in early 2007, and as a result Saudi Telecom's profit margin has declined, which prompted the company to seek foreign investment opportunities.
UAE (Dubai)	Dubai Ports World is a UAE-based port management company with operations in more than nineteen terminals worldwide, twelve of these in Asia. Three more Asian projects (in South Korea, India, and Vietnam) are currently under development. In 2006, DPW expressed an interest in operating the Gwadar port in Pakistan, but it abandoned this plan because of objections from India. DPW currently operates two ports in India and employs 97,000 people worldwide.

GCC Investments in Europe

In 2006, while many politicians in the United States were speaking out about the security risks of allowing Dubai Ports World (based in the UAE) to operate six American ports, European countries were welcoming investments by this and other GCC companies. At the same time, GCC-based investors were eagerly investing in all types of European assets. (See Table 7 below for a sample of recent acquisitions.) The volume of GCC investments in Europe has increased considerably in the past three years; the IIF estimates the flow during 2002–6 was approximately $100 billion, which makes Europe the second largest recipient of GCC investment capital after the United States.

As is the case with respect to Asia, direct and equity investments constitute a large share of GCC investments in Europe; the May 2007 IIF study cited above claims that more than 55% of GCC equity and foreign direct investments have been invested in Europe. High-net-worth GCC investors, in particular, have shown a strong interest in Europe. On several occasions in the past three decades, Saudi investors have invested in stressed European industries with long-term turnaround goals in mind. In 1994, for example, Saudi billionaire Prince Alwaleed Ben Talal purchased 24% of Euro Disney's shares for 1.9 billion francs at a time when it was suffering from severe financial troubles.

Increasing GCC investment in Europe has been matched by rapidly increasing European investment in GCC countries. In some cases, GCC firms have acquired equity stakes in European firms which have previously invested in GCC countries. The best example is the recent investment of Dubai International Capital in HSBC Holdings, which maintains an active presence in all GCC countries. In a similar case, the investment arm of Dubai International Financial Centre purchased a 2.2% stake in Deutsche Bank in 2007; Deutsche Bank has had an active presence in Dubai since 2001 and recently opened a branch in the Dubai International Financial Centre.

Foreign investment flows between GCC and Europe have enjoyed a sharp increase in both directions in the last five years.

Traditionally the GCC economies have had close trade and investment ties with Western Europe in general and the United Kingdom in particular. The UK served as the main overseas financial center for Arab investors during the oil boom era of the 1970s and continues to attract GCC investments in large quantities. The close financial relations between the UK and the GCC go back to the pre-independence era for most GCC countries: All GCC countries with the exception of Saudi Arabia were British protectorates for several decades prior to gaining independence in the 1960s and 1970s. The trade and investment ties between Europe and GCC countries have increased significantly in recent decades, and Europe is now the GCC's largest trade partner. In the 1970s, when GCC oil revenues enjoyed an unexpected sharp increase, GCC investors initially injected billions of dollars into European banks before gradually directing these funds into other investments.

Most GCC investors have shown a strong interest in well-established Western European firms. For them these firms represent relatively low-risk investments, which nicely complement their riskier investments in emerging markets. Since most GCC investors are relatively conservative, European assets constitute a sizeable portion of their portfolios. The Bahrain-based Arcapita fund, for example, has claimed that it maintains nearly one-third of its international portfolio in (Western) Europe.[32] And among Western European countries, the

United Kingdom holds a special position for GCC investors on account of the historical links referred to above.

The Eastern European countries that were admitted into the European Union after 1990 are currently the new growth subregion of the EU, but GCC investors have paid little attention to this region so far. The global flow of foreign investment into Eastern and Central Europe has sharply increased in recent years. Western Europe has been the major source of FDI for Eastern European countries; there has also been a sharp increase in U.S. investment, in response to the wave of privatization in the last decade.[33] Yet there is no evidence of visible GCC investment in this region. This could mainly be due to lack of familiarity with the region, and to the low level of economic contact between GCC countries and Eastern Europe. This situation is likely to change in the next few years, however, as Eastern Europe is expected to enjoy strong economic growth and GCC countries are sure to take notice. It was no surprise that during his European tour in June 2007, King Abdullah of Saudi Arabia paid a visit to Poland, marking the first such visit of a Saudi king. The Saudi-based Olayan Group (founded by Saudi billionaire Suliman Saleh Olayan in 1947) seems to be one of the first GCC private firms that is currently looking into investment opportunities in Eastern Europe.[34]

While European and American investors are paying more attention to Eastern Europe, GCC investments in Europe are mainly focused on the mature economies of Western Europe.

Two important contributing factors to the success of European countries in attracting GCC investment funds are their geographical proximity and their cultural familiarity with the Middle East. Based on their knowledge of Islamic culture, European financial institutions have made a special effort in recent decades to develop innovative financial investment tools that are compatible with Islamic (Sharia) law—notably Islamic banking services and Islamic investment funds. These funds are carefully managed so as to avoid investment in firms that engage in un-Islamic economic activities, such as interest-based lending or the production and sale of alcoholic beverages.[35] Since religious beliefs run deep throughout GCC societies and there are many high-net-worth religious individuals in GCC countries, the Islamic investment tools developed by European institutions have been very successful in attracting the investments of these sorts of GCC investors.

While there are many positive factors that make Europe an attractive investment destination for GCC investors, a moderate level of diplomatic risk and a rising trend toward investment protectionism should be mentioned as potential sources of concern. European governments and financial institutions are very unlikely to impose any restrictions against GCC financial assets, but they might come under pressure from the United States to do so. Since the United States enjoys a significant amount of economic and financial influence in Europe, many European financial institutions are likely to cooperate with U.S. requests for financial information or for the imposition of restrictions against specific Middle Eastern investors. A GCC investment fund might face restrictions, for example, if it is partially owned by a government or institution that the U.S. has accused of supporting terrorism. The risk of such developments in Europe is, nevertheless, much smaller than in the United States.

Suspicion of Sovereign Wealth Funds has increased the risk of investment protectionism in Europe.

Another discouraging factor for GCC investors is the rising tide of investment protectionism in European capitals—which is mainly directed at Sovereign Wealth Funds that try to acquire large stakes in major European firms. European governments are worried that the assets of these funds might be manipulated for political purposes. There is also concern about a lack of transparency in the financial and portfolio status of state-owned firms. Some European countries have already enacted legal restrictions on the acquisitions of foreign state-owned funds, and there are some indications that the EU Commission might introduce new measures to monitor and regulate the foreign investments of non-EU state-owned funds in all EU member countries.[36] It must be added, however, that European investment protectionism is not directed at GCC investors per se. Indeed, GCC investors are perceived as less of a threat than the state-owned funds of larger countries such as Russia or China. Despite these concerns, Europe will remain an attractive destination for GCC investments. As observed by many financial experts, GCC investors will most likely include European assets in their portfolios to balance the higher risk of their investments in emerging markets.

Table 7. Europe: Recent FDI and Equity Investments by GCC countries

Bahrain	Bahrain-based Arcapita purchased the Irish utility firm Viridian Group for $4.2 billion in 2006. This was by far the largest foreign acquisition by Arcapita up to that date.
Kuwait	In June 2007, two Kuwait-based investment firms, Investment Dar and Adeem Investment, formed a consortium with two British investors to purchase the automaker Aston Martin for $965 million. The contribution of these two Kuwaiti firms was approximately $530 million.
Qatar	In April 2007, Delta Two, a Qatari investment group which is controlled by Qatar's al-Thani royal family, purchased a 17.4% stake in the British supermarket chain J Sainsbury. Delta Two's stake grew to 25% by July 2007, when it made a cash offer for the remaining shares. The Qatari firm is primarily interested in Sainsbury's real estate property holdings. Qatar Investment Authority also held a 15% stake in London Stock Exchange as of April 2008.
Saudi Arabia	The Saudi Basic Industries Corporation (SABIC) has established a subsidiary in Europe (SABIC Europe) to manage its European holdings. SABIC Europe operates three petrochemical units in the Netherlands, Germany, and the United Kingdom. It employed 3,300 people in 2006.
Saudi Arabia	Saudi billionaire Maan al-Sanea has purchased $6.6 billion shares of HSBC Holdings, which is one of the largest financial institutions in Europe. The purchase took place gradually, between February and April of 2007, and made Al-Sanea the second largest investor in HSBC, with a 3.1% stake.
Saudi Arabia	In July 2007, Saudi-based National Commercial Bank purchased a 60% stake in a Turkish Islamic bank called Türkiye Finans. The purchase value was reported at $1.08 billion. Türkiye Finans offers interest-free banking products to households and business borrowers in compliance with Islamic law. National Commercial Bank is the largest Saudi Bank, with total assets valued at $41.5 billion in 2006.
UAE	In April 2007, the Emirates International Investment Company (EIIC, based in Abu Dhabi) purchased a 3% stake in Vivendi (a French telecommunications and media company) for $1.5 billion. EIIC's stake was large enough to earn it a seat on Vivendi's supervisory board.

UAE	In April 2006, Dubai International Capital acquired the UK hotel chain Travelodge for □675 million. Travelodge was the fastest growing hotel chain in Britain at the time of this purchase.
UAE	DIFC Investments, which serves as the investment arm of Dubai International Financial Centre, purchased a 2.2% stake in Deutsche Bank AG in May 2007. The value of this transaction was estimated at close to 1.35 billion euros.
UAE (Abu Dhabi)	Mubadala Development Company of Abu Dhabi purchased a 5% stake in the Italian automaker Ferrari in 2005. The deal was worth 114 million euros. Mubadala is one of the investment arms of the Abu Dhabi government, which is the main UAE emirate. Mubadala also owns a 25% stake in SR Technics, one of the largest automobile maintenance and repair service providers in Europe.
UAE (Dubai)	Dubai International Capital purchased a 3.12% stake in the European aerospace firm EADS in July 2007. It also purchased an undisclosed but substantial number of HSBC shares in May 2007. HSBC is one of the largest European banks, and with this purchase DIC has emerged as one of its largest shareholders. In 2006, DIC and HSBC established a joint fund for investment in infrastructural projects throughout the Middle East.

Summary and Conclusions

The high price of crude oil in the past five years has led to the transfer of a large amount of money from the oil-importing countries to the oil-exporting ones. For some oil-exporting countries, including the six Arab states of the Gulf Cooperation Council, the rapid increase in oil revenues has led to record high current account surpluses and the accumulation of sizeable foreign assets. A recent study by the Institute of International Finance estimates the value of GCC foreign assets at $1,550 billion; based on various projections, the value of these assets will rise to at least $2,800 billion by 2012. Whereas in the 1970s and 1980s, GCC investors were primarily attracted to safe, fixed income assets in the United States and Western Europe, in recent years they are showing a stronger interest in equity and FDI investment opportunities in both mature and emerging markets.

The available evidence also shows that GCC investors are still interested in U.S. government securities, but they have some reservations regarding foreign direct investment and the visible takeover of strategic assets in the United

States: They are concerned that unexpected diplomatic tensions between the U.S. and the Arab world could leave their assets vulnerable to legal action on the part of the American government and American courts. GCC investors have purchased equity interests in a few large investment projects in the United States; more recently, they have also invested in American financial institutions that have suffered because of the sub-prime mortgage crisis. GCC acquisitions in Europe and Asia in recent years have increased at a faster pace in comparison with their investments in American equity assets.

Asian countries have made a special effort to attract GCC investment in recent years. Following in the footsteps of major European banks, some Asian financial institutions have established special investment funds that comply with Islamic law. Islamic financial institutions in Malaysia and Indonesia have developed partnerships with their counterparts in Kuwait and Bahrain with respect to investments in telecommunications, banking, and real estate throughout Asia. Among Asian countries, China has captured the largest share of GCC investments. Saudi Arabia and Kuwait are investing in China's refinery and petrochemical industries in order to secure long-term access to China's fast-growing energy market.

The large volume of GCC foreign assets has substantially increased the influence of GCC investors in global financial markets. A sizeable share of GCC foreign investments is controlled by government-owned Sovereign Wealth Funds—and control over the portfolios of these funds has likewise increased the global financial influence of GCC governments beyond their relatively small economic size. Industrial and emerging market countries alike are eagerly trying to expand their economic relationships with GCC countries and thereby attract their investments. This growing economic power will increase the political power of GCC governments and enhance their diplomatic standing in international institutions such as the World Bank, the International Monetary Fund, and the United Nations.

As oil-exporting countries accumulate more oil revenues, it is necessary for them to maintain a diversified and well-managed portfolio of foreign assets. Transferring a portion of their oil revenues into overseas investments will prevent overheating in their domestic economies, and the investment revenues will also be a valuable source of income in the future. The global economy, too, is benefiting from the circulation of petrodollars. The flow of GCC investments into emerging markets has contributed to economic growth and job creation in the recipient countries. GCC investments in U.S. government securities have helped finance the United States' large trade deficits and helped keep the U.S. interest rates low. Furthermore, the equity investments of GCC Sovereign

Wealth Funds in U.S. financial institutions that have been hurt by the 2007 real estate crisis have provided these firms with much-needed liquidity.

Yet, at the same time, the sharp increase in the foreign holdings of state-owned wealth funds and state-owned enterprises poses several challenges for global financial markets and for the recipient countries. Some experts are concerned that the growing influx of foreign investment might exert excessive upward pressure on asset prices and increase their vulnerability to rapid fluctuations. There is also a fear that Sovereign Wealth Funds might be exploited for political and strategic purposes that might harm the host economies. The United States, Japan, and several European countries are in various stages of tightening their rules and regulations regarding investments by Sovereign Wealth Funds. They are also moving toward multilateral negotiations to develop universal rules and standards for the operation of SWFs.

So far, these concerns and criticisms have been ignored or rejected by governments that own large SWFs. Nevertheless, some form of international standards for SWFs might be introduced in the next few years. As recommended by several experts, these state-owned wealth funds may have to become more transparent about the size and composition of their portfolios in order to gain the trust of host countries with respect to large equity purchases.

The Western governments that are calling for these new regulations, however, must be careful about alienating GCC and other oil-exporting countries via over-regulation of Sovereign Wealth Funds. Unfortunately, the policy debate over the regulation of SWFs might be vulnerable to ideological and cultural bias. Such biases can lead to exaggerated fears about SWFs being used as political tools by authoritarian governments in order to undermine Western liberal economies.[37] In fact, so far there is no evidence of SWFs being used by any government to conduct economic warfare.

Overall, the development of balanced and multilateral regulations governing the operation of Sovereign Wealth Funds could have many positive benefits for both sides. To be effective, such regulations must encourage and welcome investments by SWFs while at the same time addressing recipient countries' fears concerning the political manipulation of these funds and the risks of financial instability. The proper investment of GCC countries' huge oil wealth will play a key role in both addressing current imbalances in the global economy and facilitating economic growth worldwide. The sound investment of these assets is also vital for the long-term economic health of GCC economies themselves. If properly invested, these assets can be a major source of long-term income for these economies.

Appendix A: Statistical Overview of GCC Countries

	2000	2001	2002	2003	2004	2005
GDP (Nominal, in billions of dollars)	342.3	332.8	349.5	405.0	481.4	609.7
Share of Middle East and North Africa (MENA) GDP (percent)	45.2	44.7	44.7	46.5	46.3	48.3
Real Economic Growth Rate (Percent)	3.0	3.5	3.5	2.8	6.4	4.2
Population (in millions)	30.6	31.6	32.6	33.3	34.5	35.6
Share of MENA population (percent)	8.9	8.9	9.0	9.1	9.2	9.3
GDP per capita (in U.S. dollars)	11185	10544	10735	12160	13964	17142
Imports of Goods (in billions of U.S. dollars)	77.2	81.9	89.6	105.3	135.5	165.5
Current Account Balance (in billions of dollars)	49.8	30.9	24.6	52.1	89.9	160.8
CAB as a share of GDP	14.5%	9.3%	7.0%	12.9%	18.7%	26.4%
Average annual inflation rate	0.03%	0.51%	0.60%	1.13%	1.96%	2.94%

Source: International Monetary Fund, Central banks of GCC countries.

Chart 3. Per Capita Income of GCC Countries (in thousands of dollars)

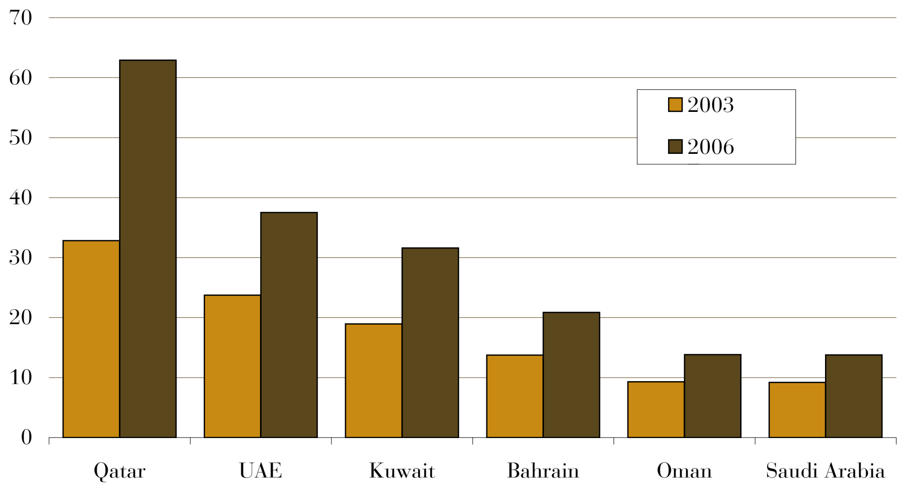
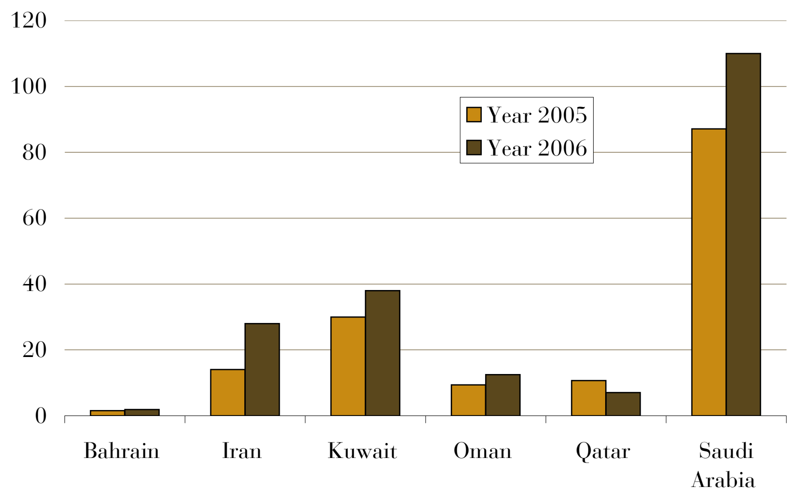


Chart 4. Current Account Balances of GCC Countries (in billions of dollars)



Appendix B: State-Owned Wealth Funds in GCC Countries

GCC governments, like those of many other oil-exporting countries, have established independent entities to manage their surplus oil revenues. Known generally as Sovereign Wealth Funds (SWFs), these institutions operate independently of their countries' central banks. (Since the surplus oil revenues of these countries are significantly larger than the international reserves needed for the management of international transactions, there is no need to leave all of them under the control of central banks.) The SWFs are oriented to long-term investment plans, and unlike central banks, they don't have to worry about short-term liquidity. Their long-term investment horizon allows SWFs to allocate a large share of their portfolio to equity investments. It has also encouraged some to pay attention to emerging markets, which entail larger investment risks but offer higher growth prospects.[38] Whereas in the past, the SWFs of Arab countries relied on European investment firms to manage their funds, in recent years they have developed in-house expertise in international financial management. By offering competitive salaries, they have been able to employ highly qualified financial experts. Unfortunately, these SWFs release very little information about their international portfolios or their internal organization.[39]

So far four GCC governments have created SWFs, which will be described below, based on the limited public information that is currently available about them. The Saudi Arabian government's foreign assets are substantial, but they remain under the supervision of the Saudi Arabian Monetary Agency (the country's central bank). The net foreign assets of the Agency quadrupled in the span of four years, reaching $221 billion at the end of December 2006, equal to roughly 64% of the country's GDP.

The assets of the Abu Dhabi Investment Authority (ADIA) are estimated at approximately $500 billion as of the end of 2006, which makes it one of the largest institutional investors in the world. ADIA manages the assets of the UAE's largest and richest emirate, Abu Dhabi. It was created by the founding leader of Abu Dhabi, Sheikh Zayed al-Nahyan, in 1977. ADIA reports to the Abu Dhabi Investment Council and manages its portfolio through its various subsidiaries in the UAE and Bahrain. According to a recent interview with *Euromoney*, ADIA is actively investing in equity assets in emerging markets of Asia and Middle East.

Established in 1953 by the government of Kuwait to manage its various wealth funds, the Kuwait Investment Authority (KIA) maintains a large operations office in London. The two largest funds under KIA control are the General Reserve Fund and the Future Generations Fund.[40] The General Reserve Fund acts as the treasury of the government of Kuwait. Every year, 10% of Kuwait's oil revenues are deposited in the Future Generations Fund, and all investment income is reinvested. While the KIA maintains assets both inside and outside of Kuwait, its foreign assets are substantial. These assets played a crucial role in funding the government when the leadership of Kuwait fled the country ahead of the Iraqi invasion of 1991. The KIA maintains a diverse and balanced portfolio, which includes equity and fixed income assets in North America, Europe, and Asia.

Established by the government of Qatar in 2000, the Qatar Investment Authority (QIA) was worth approximately $50 billion in mid-2007. The QIA, which is primarily interested in the acquisition of financial institutions, maintains assets in Qatar, the UK, Lebanon, Jordan, France, and Singapore. It has pledged to increase its investments in China and other Asian countries in 2007–8.[41]

Established in 2004 as the international investment arm of Dubai Holding, Dubai International Capital (DIC) is mainly focused on equity investment. Dubai Holding belongs to the ruling family of Dubai, Sheikh Mohammad bin Rashid al-Makhtum. As such it is indirectly owned by the government of the emirate of Dubai. In early 2007, DIC assets were valued at approximately $5.5 billion, but they were expected to grow to $20 billion by 2012.[42]

Endnotes

1 See Appendix 1 for a statistical overview of the GCC countries.

2 This phenomenon is known as the indirect recycling of petrodollars and has received a good deal of attention in recent years. See Matthew Higgins, Thomas Klitgaard, and Robert Lerman, "Recycling Petrodollars," Federal Reserve Bank of New York, *Current Issues in Economics and Finance* 12, no. 9 (December 2006).

3 The UAE and Qatar experienced record high inflation rates in the range of 6%–10% in 2006. In order to reduce the excess domestic liquidity, the Central Bank of the UAE issued domestic bonds and invested the proceeds overseas.

4 Another development that has added to the inflationary pressures in GGC countries is the weakness of the dollar against other major currencies. The GCC countries have maintained a fixed exchange rate against the U.S. dollar for more than a decade. Since these countries import a large volume of goods and services from Europe, the depreciation of the dollar against the euro has increased the cost of their imports. This fixed exchange rate has also denied GCC countries the option to reduce their domestic inflation rate by raising interest rates; instead, they have been forced to follow the recent reductions in U.S. prime rates, and this policy has led to further increases in monetary liquidity. Consequently there have been growing calls for revaluation of GCC currencies, and Kuwait has already switched from a dollar peg to a new exchange rate peg against a basket of currencies, which includes the euro as well as the dollar. Other GCC countries might be forced to abandon their fixed exchange rate against the dollar in 2008 if the weakness of the dollar continues.

5 The United States government is helping GCC countries conceal their U.S. investments by refusing to report holdings of U.S. securities at the country level. Instead it reports an aggregate figure for eight Middle East oil-exporting countries: namely, the six GCC countries plus Libya and Algeria.

6 See Institute of International Finance, "Tracking GCC Petrodollars: How and Where They Are Being Invested around the World" (paper presented at a financial conference in Kuwait City, Kuwait, 2007).

7 For a mathematical description of how current account surpluses become equivalent to net changes in foreign assets, see Ali Bolbol and Ali T. Sadik, "Arab External Investments: Relation to National Estimation and Consequences," *World Development* 31, issue 11 (November 2003): pp. 1771-92.

8 Source is same as in footnote 6.

9 Philip R. Lane and Gian Maria Milesi-Ferretti, "The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970–2004," IMF Working Paper #WP/06/69, Washington, D.C., 2006.

10 The differences between the two estimates are partly due to the different methods that have been utilized by Lane/Milesi-Ferretti and the IIF. While the IIF report does not include 2004 data that can be used for comparison, it is very likely that the respective asset estimates for 2004 were also significantly different.

11 In the first six weeks of 2008 the price of oil exceeded $90 per barrel, but I prefer to use more conservative projections, because there is a strong possibility of economic slowdown in the United States during 2008 and 2009, which will soften the demand for crude oil and keep the price below $80 per barrel. At the same time, we cannot ignore the likelihood that the average price of oil will increase above $90 per barrel as some oil fields mature and their daily yields decline. The advocates of Peak Oil theory believe that global oil production has already reached its peak and will gradually decline from here on in. If these predictions are true, the oil revenues of GCC countries will exceed our current projections.

12 Ramin Toloui, "Petrodollars, Asset Prices, and the Global Financial System," *Capital Perspectives* (January 2007).*

13 See Eckart Woertz, "West's Growing Fear of State Funds," Gulf in the Media, July 30, 2007.*

14 So far the investment behavior of GCC and Chinese SWFs does not show any indications of politically motivated intervention in the management of the firms that these funds have invested in. Indeed, the GCC-based funds prefer to be passive investors even when their equity share in a firm would allow them to play an active role in the board of directors. During the January 2008 World Economic Forum gathering in Davos, the managing director of the Kuwait Investment Authority, Bader al Sa'ad, noted that "Kuwait has been a shareholder in DaimlerBenz since 1969, and in BP since 1986. For 55 years, we never had politically enforced decisions for our investment." [government officials did not interfere in our investment decisions for political purposes]. See Edmund Conway, "Sovereign Wealth Funds Deny Possibility of Political Interference," *Telegraph*, January 26, 2008.*

15 Truman, Edwin M., "Sovereign Wealth Funds: The Need for Greater Transparency and Accountability," Peterson Institute Policy Brief # PB07-6, August 2007.

16 Since the pro-American foreign policy of GCC countries leads to strong resentment among some segments of their domestic population, citizens of GCC countries are more likely to be involved in anti-Western terrorist activities—and GCC countries' assets in the U.S.are therefore particularly vulnerable to the potential diplomatic risks associated with a major terrorist attack.

17 Even an unstable country like Lebanon was able to attract a large amount of GCC real estate investment in the few years prior to the Hezbollah-Israel war of 2006.

18 This section is devoted to the geographical distribution of GCC investments; but another useful exercise would be to focus on the distribution of GCC investments among major economic *sectors*. An excellent recent analysis of this topic is available in John Sfakianakis

and Eckart Woertz, "Strategic Foreign Investments of GCC Countries," Gulf Geo-economics (Gulf Research Center, Dubai, 2007): pp. 131–46.

19 Two 2006 articles offer some details about the impact of diplomatic and political considerations on Middle East investments in the United States. Simon Romero ("International Investors Largely Avoid U.S.," *International Herald Tribune*, February 26, 2006) focuses on the value of foreign direct investment in the United States and notes that only 1% of more than $1.5 trillion FDI in the U.S. economy (as of the end of 2004) originated in the Middle East. Paul Blustein ("Middle East Investment Up in the U.S.," *Washington Post*, March 7, 2006) looks at annual data on foreign acquisitions in the United States and observes that after a significant drop in the value of Middle East asset acquisitions during 2001–3, the trend was reversed in 2004 and 2005, with a very sharp increase in 2004.

20 See "Saudi Prince Denies US Asset Flight," *BBC News, World Edition* (August 22, 2002).*

21 Dubai Ports World had acquired contracts to manage a number of U.S. ports in early 2006 as part of a $6.8 billion purchase of the British port operator P&O. The controversy over DPW angered some UAE officials. The UAE economy minister, Sheikha Lubna bint Khalid al Qasimi, hinted that the controversy would discourage some Arab investors from putting their money in the U.S. at a time when other countries were actively competing for Arab investment.

22 See: "Gulf Arab Investors Target Asia as U.S. Ties Wane," Reuters, March 28, 2007.* These data appear in a 2007 report by the U.S. Bureau of Economic Analysis on FDI inflows into the United States. Burea of Economic Analysis, "Foreign Direct Investors' Outlays to Acquire or Establish U.S. Businesses Increased in 2006," U.S. Department of Commerce, June 2007, BEA 07-23.*

24 In a May 2002 interview with *Arab News*, Saudi billionaire Prince Alwaleed bin Talal suggested that Arabs can exert influence over U.S. foreign policy if they use their economic power in full coordination with each other.

25 Edward Evans, "Merrill Lynch Gets $6.6 Billion from Kuwait, Mizuho," Bloomberg.com, January 15, 2008.*

26 The evidence of this growing GCC interest in Asia is described in the same Reuters report cited in note 22.

27 While the United States has announced that it plans to reduce its dependence on Middle East oil, Asian countries have been eager to sign long-term oil purchase contracts with GCC countries. Asia's share of Saudi Arabia's oil exports has increased from 48% in 2002 to 54% in 2005; its share of Oman's exports stood at 82% in 2006. GCC oil exports accounted for nearly two-thirds of Asia's total oil imports in 2005. (Source: U.S. Department Of Energy, Energy Information Administration, and International Energy Agency.)

28 Although according to Japan's Shingetsu Institute, the volume of GCC investments in Japan was more than $25 billion as of December 2006, most of these investments had been made in earlier years. The volume of bilateral trade between Japan and GCC countries remained substantial at $90 billion in December 2006. (See Shingetsu Institute Newsletter No. 454, December 3, 2006.*)

29 The fate of this project is still unclear, and SABIC officials have complained that Chinese authorities are taking too long to approve it. See: "Saudis May Drop Planned China Petrochemical Plant," *International Herald Tribune*, February 25, 2007.*

30 See "Barrels of Capital," *AltAssets*, September 5, 2007.*

31 See "Indonesia Planning to Sell Islamic Bonds," *International Herald Tribune*, July 18, 2006.*

32 See Fredrik Richter and James Exelby, "The World's Richest Arabs," *CNBC European Business*, May 2007.*

33 In 2005 the United States accounted for 12% of FDI inflow into Eastern Europe, followed by Germany (11%), Austria (10%), and the UK (10%). Source: David Bartlett, "M&A in Eastern Europe," *Finance Director Europe*, September 22, 2006.*

34 Reported in Richter and Exelby, "The World's Richest Arabs."

35 The UK-based HSBC bank, for example, offers more than ten different Sharia-compliant equity funds through its UAE subsidiaries. Another major European bank, Deutsche Bank, launched DWS Noor Islamic Funds, comprising five Sharia-compliant mutual funds, in the UAE and Bahrain in December 2006. (See "Deutsche Bank Offers Shari'a Mutual Fund Capability" (press release), December, 6, 2006.*

36 See "EU to Consider Protection from State-Funded Foreign Takeovers," EurActiv.com, July 24, 2007.* Some European countries fear that foreign takeovers of firms in sensitive industries might be motivated by political and strategic considerations rather than by economic motives. The United States already has a mechanism in place to review (and block) foreign investment proposals on national security grounds; the EU Commission might call for a similar procedure for Europe. One possible option for the EU is to grant member governments a golden share in companies that are taken over by foreign investors. Such decisions will mainly affect the sectors that are considered strategic by governments. A set of initial recommendations on this issue was released by the EU Commission in February 2008. (See "Sovereign Wealth Funds and Financial Stability Guide" February 27, 2008.*)

37 For an example of this type of negative campaign against SWFs, see David J. Jonsson, "Sovereign Wealth Funds: A Potential Tool of Asymmetric Warfare," The New Media Journal.US (August 11, 2007).*

38 This growing preference for emerging markets was expressed by high-ranking officials of the Abu Dhabi Investment Authority (ADIA) in an April 2006 interview in Sudip Roy, "Money and Mystery: ADIA Unveils Its Secrets," *Euromoney*.

39 Interest in SWFs has sharply increased since 2007. In a recent article in *BusinessWeek*, Emily Thornton and Stanley Reed offer detailed profiles of four fund managers who are currently managing state-owned wealth funds in Kuwait and the United Arab Emirates ("Who's Afraid of Mideast Money?" [January 10, 2008].*)

40 Kuwait has deliberately invested a significant portion of its oil earnings in foreign assets so as to build a source of income for future generations. This tradition began in the 1950s. The Future Generations Fund was established in 1976. By the late 1980s. Kuwait's investment income was larger than its oil revenues: In 1987, foreign investment income was $6.3 billion while oil revenues reached $5.4 billion.

41 See: "Qatar Investment Authority Seeking to Buy Asian Assets," *GulfBase*, September 5, 2007 (Bloomberg).*

42 See: "Dubai International Capital Announces Appointment of New COO," *AME Info*, February 5, 2007.*

* Weblinks are available in the PDF version found at www.brandeis.edu/crown

About the Author

Nader Habibi is the Henry J. Leir Professor of the Economics of the Middle East. Habibi was most recently Managing Director of the Middle East and North Africa Division in Global Insight. His expertise is the impact of political institutions on fiscal and monetary policy, and economic reform in the Middle East. He holds a Ph.D. in economics and a graduate degree in systems engineering from Michigan State University and has worked as a research fellow at the Middle East Council at Yale University.

Crown Center for Middle East Studies

The Crown Center for Middle East Studies at Brandeis Univeristy is committed to producing balanced and dispassionate research regarding all aspects of the contemporary Middle East.

The Center's research staff reflects its broad geopolitical focus, employing experienced researchers with high-level expertise about Egypt, Israel, Palestine, Turkey, Iraq, Iran and Saudi Arabia. The Center's activities include conducting conferences, seminars, and workshops. In addition to publishing basic research in the form of books and monographs, the Center has created tools for "real-time" distribution of analyses regarding current developments and events in the Middle East with the Middle East Brief. In addition to their research activities, the Center's staff teaches undergraduate- and graduate-level courses at Brandeis University. With a commitment to objective research and such a wide array of activities, the Crown Center is taking its place as a leading university research center for the study of the Middle East.

For more information and to view all Crown Center publications, please visit www.brandeis.edu/crown