Referee report prepared for the manuscript "Are the GCC FDI Location Determinants Favorable?"

This paper examines the role of various country characteristics, such as market size, trade openness, institutional quality and human capital, in explaining the level of inward FDI in GCC countries. The results show that both market size, measured by real GDP per capita, and trade openness have a positive impact on the FDI inflow. It is also shown that institutional quality has a significant and positive effect on the FDI during the period of 1983-2002. Human capital, however, is found to be negatively correlated with the level of FDI inflows.

This paper searches for the determinants of FDI in the case of GCC countries. This kind of study is useful not only because this region is economically distinct from the rest of the world but also because FDI is an important means to diversify this region's economy. However, the investigation undertaken in this paper can be improved in several aspects to better address the question raised in the paper. I set out my major concerns below:

1. The paper uses the country aggregate data of FDI inflows, which inevitably would miss many important insights. Having either industry-level data or data of the FDI source countries would be very helpful, especially if the author is interested in the role of FDI in diversifying the domestic economies. The availability of such data could be a challenge, but check the UNCTAD FDI database to explore this possibility.
2. The paper omits many important variables, such as corporate tax rate, factor abundance (especially the abundance of labor and oil), and infrastructure, which could be crucial determinants of FDI. Furthermore, this paper measures institutional quality using the rule-of-law index. In my view, more governance indicators, such as political stability and corruption, should be included. To establish this paper's contribution to the vast literature of FDI, the paper needs to take more of this region's own characteristics into account.
3. It is shown in the paper that market size, measure by real GDP per capita, is an important determinant of FDI. However, the market size of the proximate countries

could also play a role. Head and Mayer (2004), for example, address the importance of a country's market potential in attracting FDI.

4. The paper finds that human capital is negatively correlated with the level of inward FDI but does not offer any explanation to this "unexpected" result. In fact, this result is not surprising if the multinational production in the GCC countries is mostly unskilled-labor intensive (see, Yeaple, 2003). However, in any case the implication of this result laid out in the second paragraph of the conclusion section seems arbitrary and misleading.
5. The author needs to have a more thorough review of the related literature. For example, the literature on the knowledge-capital model of FDI (e.g., Brainard, 1997; Carr, Markusen, and Maskus, 2001; Yeaple, 2003). This literature will be particularly relevant if the author could access and examine industry-level FDI or identify the sources of the FDI in these countries.
6. The paper acknowledges the potential endogeneity of some explanatory variables due to omitted variables, measurement error, and simultaneity bias. However, the approaches, i.e., the county random or fixed effect, employed in the paper are not adequate to address this issue. First, the time trend is not captured in the regressions. Second, the fixed effect would solve the simultaneity bias, especially since the paper examines the country aggregate FDI. This bias is most severe now because the paper does not allow any time lags between the explanatory variables and dependent variable.

Some relatively minor issues. In my opinion, the title of the paper (and some similar discussions in the paper) seems rather confusing and should probably be rephrased to accurately capture the main research question of the paper. The other relatively minor issue is that the paper devotes an excessively large number of pages and tables to describing the characteristics of the region but not enough to discussing the results and establishing their robustness.

References:

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Carr, David, James Markusen, and Keith Maskus. 2001. “Estimating the Knowledge-Capital Model of the Multinational Enterprise”. *American Economic Review* 91: 691-708.

Head, Keith, and Thierry Mayer. 2004. “Market Potential and the Location of Japanese Investment in the European Union.” *Review of Economics and Statistics* 86: 959-72.

Yeaple, Stephen. 2003. “The Role of Skill Endowments in the Structure of U.S. Outward Foreign Direct Investment.” *Review of Economics and Statistics* 85: 726-34.