

FDI FLOWS IN THE MENA REGION: FEATURES AND IMPACTS

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I. Introduction



One of the most important aspects of globalization during the last three decades has been the spectacular surge of Foreign Direct Investment (FDI). Indeed, since the 1980s barriers to foreign investment have fallen gradually to leave the place to open, globalized markets. Governments across the globe are now competing with each other to capture a larger share of the investment coming from international companies. The increase on FDI flows has also come with a change in the composition of the sources and destinations of those flows, with an increasing participation of regions that a short time ago were marginalized. Until recently, the interest was mainly on flows of FDI originating in advanced economies, but the role of developing countries has increased substantially in recent years (UNCTAD 2006). Brazil, Russia, India, and China, together with a reduced set of emerging countries, including Malaysia and South Africa, are behind this new phenomenon, which has seen the South becoming an important source and destination of FDI (Depetris-Chauvin 2011). In this context of a new geography for FDI flows, the intention of this article is to shine some light onto the main features and impact of FDI in the Middle East and North Africa (MENA) region.

The economies of the MENA region are very diverse but can be grouped basically into three groups: oil exporters (the six GCC countries and Libya), developing oil countries (Algeria, Iran, Iraq, Syria, and Yemen) and oil-importing countries (Egypt, Morocco, Tunisia, Jordan, and Lebanon). Understanding the relationship of each country with oil is essential to understanding the role FDI plays in each of them, as we will explain later on. Overall, the MENA is on a “middle of the pack” growth path, with the average growth rate in the last ten years (4.7%) falling between the growth rate of OECD countries (2.0%) and the BRICs (8.1%). By the end of 2010, most countries in the MENA region had largely recovered from the global financial crisis, and growth rates were expected to reach pre-crisis levels from 2011 onwards. However, in early 2011, a series of anti-establishment and prodemocracy movements began that resulted in swift regime changes in Tunisia, Egypt, and Libya, spreading also to Bahrain, Syria, and Yemen. The unrest and uncertainty associated with these movements have affected the short-term macroeconomic outlook, and FDI flows are likely to decline temporarily as investors wait for uncertainty to be resolved. In the medium-run, however, growth prospects and FDI inflows are likely to improve, especially if the political changes are associated with more open and accountable governance and more rapid reforms (World Bank 2011, Barbour et al 2012).

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Given its enormous endowment of hydrocarbons and frequent price shocks since the mid-1970s, the MENA region has been an important source of capital flows and wealth accumulation. This paper reviews the significance of MENA FDI flows by looking at the specific key issues for the region. We also evaluate the impact of FDI flows on economic growth, employment, technology transfer, productivity, infrastructure, trade, and other side effects that may be associated with FDI. We conclude with an assessment of the perspective of FDI in the region and the persisting policy challenges that need to be addressed.

II.

Main Characteristics of FDI Flows in MENA Countries



FDI Flows to MENA Have Significantly Increased (but are still modest in relative terms)

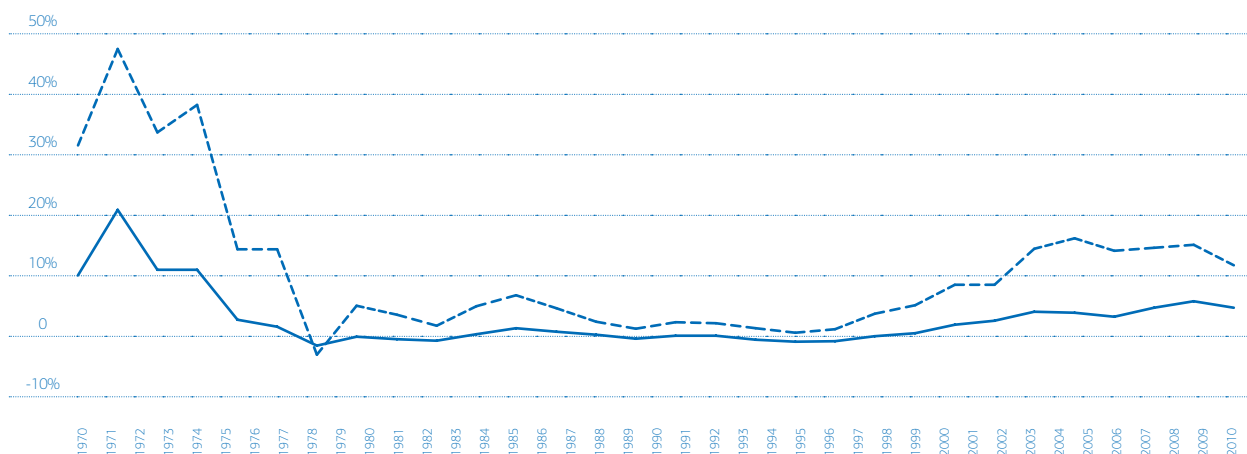
Global FDI has surged in the past twenty years from USD 207 billion in 1990 to USD 1.25 trillion in 2010 (peaking at USD 1.9 trillion in 2007). FDI has also dramatically increased in the MENA with the inflows increasing by 6 times between 1990 and 2000 and by 12 times between 2000 and 2010. The dynamic of the last ten years has allowed MENA countries to claim a larger share of global FDI flows. Figure 1 shows that although FDI inflows for MENA countries have increased considerably, especially since 2003, they were only 5.5% of total FDI flows in comparison to the peak of 20% reached in the early 1980s.

Generally, FDI inflow to MENA countries witnessed a very fast increase since 2001. Total FDI inflows in 2008 attained a new record high of USD 95 billion, which represents 14.4% of total inflows to developing countries, compared to USD 5.6 billion in 2000 that represents only 2.2% of FDI inflow to developing countries. The strong growth in FDI inflows to the MENA region reflects positive economic situations, mainly in the oil-rich GCC countries, the

progress in the business environment, and the regulatory framework, in addition to the privatization of state-owned enterprises in several countries. However, this positive trend was interrupted by the international economic crisis, with FDI flows decreasing 25% in 2009 and a further 12% in 2010 (Figure 2). Flows were, in principle, expected to recover in 2011, but probably the final numbers for 2011 will show a further decline because of the unrest in several Arab countries and the cancellation of some mega projects by Saudi Arabia and the UAE.

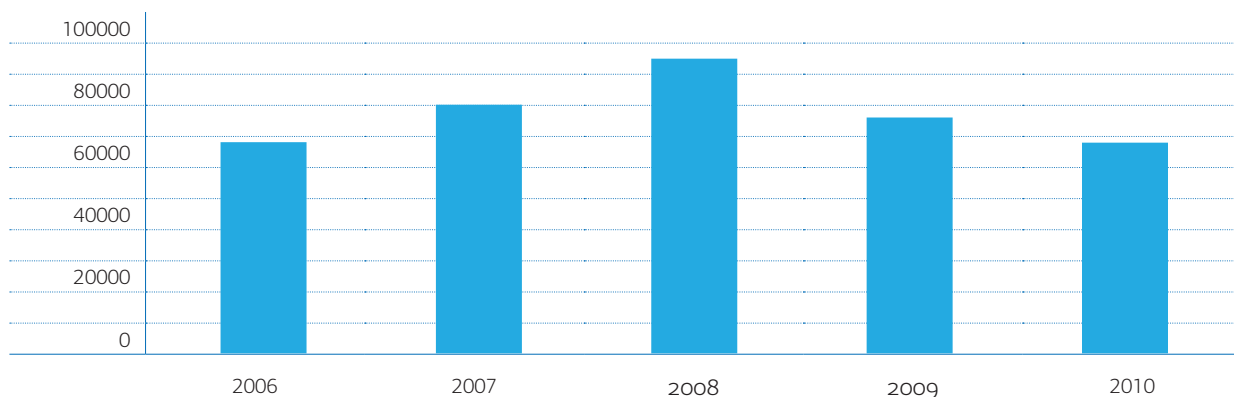
Despite the negative effects of the crisis, the increase of FDI flows to the MENA region can be compared to the dynamics observed in BRIC countries (Figure 3). As a region, in 2010 MENA received more FDI flows than any BRIC country but China. Since 2000, FDI flows have increased at a higher rate in MENA than in all BRIC countries but Russia. If we take MENA countries individually, Saudi Arabia is the only country in the region appearing in the top 20 FDI host economies for 2010 in the 12th position, behind China (2nd), Brazil (5th), and Russia (8th), but ahead of India (14th). Outside the top twenty, the largest MENA recipients in 2010 were Egypt (35th), Qatar (39th), Lebanon (42th), and the UAE (45th). Table 1 displays FDI

Figure 1: MENA Region FDI Inflows as a Proportion of Developing Countries and World FDI inflows (1980-2010)



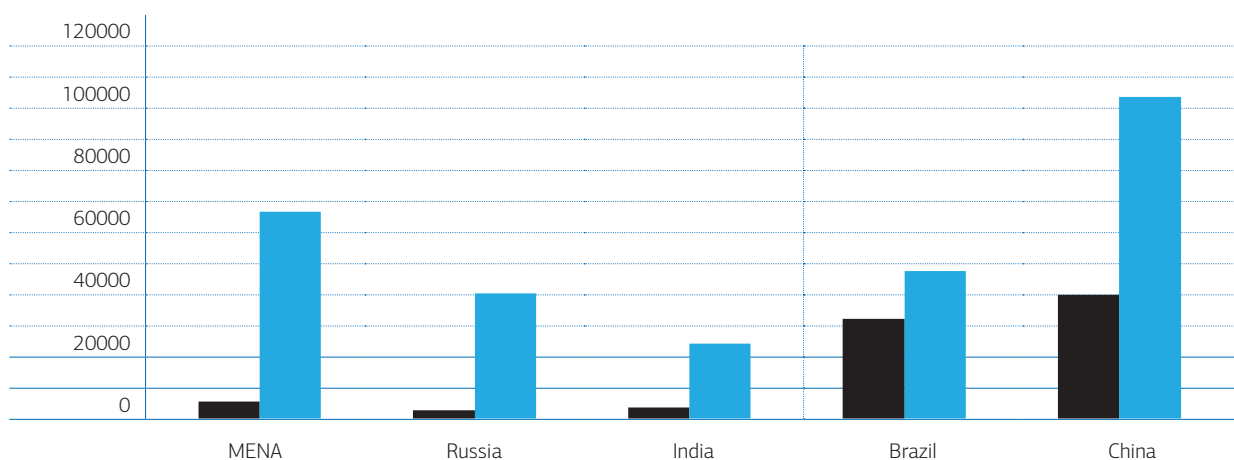
Legend: MENA/Developing Countries ----- MENA/World ———
Source: UNCTAD

Figure 2: MENA Region FDI Inflows (2006–2010 in millions of current USD)



Source: UNCTAD

Figure 3: FDI Inflows to the MENA Region and the BRICs (2000 vs 2010 in millions of current USD)



Legend: 2000 ■ 2010 ■ Source: UNCTAD

Table 1: FDI Inflows as a Share of GDP: MENA vs BRICs (2000, 2005, and 2010)

	2000	2005	2010
MENA - Oil Exporting Countries	0.9	4.7	3.1
MENA - Developing Oil Exporting Countries	0.4	1.2	1.6
MENA - Oil Importing Countries	4.6	8.4	5.4
Brazil	5.1	1.7	2.3
Russia	1.0	1.7	2.8
India	0.8	0.9	1.5
China	3.4	3.1	1.8

Source: UNCTAD

flows as a share of GDP for both MENA and BRIC countries showing the relative importance these flows have for the sub-group of oil-importing countries in MENA.

Overall, and despite the recovery observed during the 2000s, we could argue that the MENA region receives only a small share of inflows targeting developing countries. According to the UNCTAD report (cite), the modest levels of FDI inflows in general are due to factors such as a deficient regulatory framework, a poor business environment, weak FDI policies and incentives, poor institutional frameworks, limited market access, unfavorable comparative costs, and lack of political stability. For MENA countries in particular, some economic studies (see, for instance, Oneyeiwu, 2003) find that some of the determinants of FDI flows to developing countries, such as the rate of return, infrastructure, and economic fundamentals, are not relevant to explain FDI flows to these countries. Furthermore, corruption, bureaucratic red tape, and trade protection, in addition to political instability, are the two more significant factors to explain why the MENA region receives less FDI than other developing regions (Kaufmann and Stone, 2000). A recent study (Mohamed and Sidiropoulos, 2010) tests for the internal as well as the external factors affect-

ing FDI inflows in the MENA region and finds similar determinants.

Concentration of FDI Flows in a Few MENA Countries and Sectors

In 2010, more than 83% of FDI inflows in the MENA region were concentrated in 7 countries (Figure 4): Saudi Arabia (41.4%), Egypt (9.4%), Qatar (8.1%), Lebanon (7.3%), United Arab Emirates (5.8%), Libya (5.6%), and Iran (5.3%). This distribution is not only particular to 2010 but also of the whole previous decade where Saudi Arabia received 29% of all FDI inflows, followed by the UAE with 16.2% and Egypt with 11%. In the first two cases, the flows are explained by the process of economic diversification followed by the two countries. Egypt holds third place, but its FDI inflows are well below expected levels for a country of its population and GDP. The toppling of the Mubarak regime — although a welcome sign to democracy advocates — has increased the degree of political instability over the past two years, which, in turn, has hindered FDI flows. As Figure 5 shows, the lion's share of FDI inflows corresponded to oil-producing countries. Nevertheless, the majority of the other larger oil-producing countries (Algeria, Libya, and Kuwait) receive very low FDI relative to ex-

Figure 4: FDI Inflows by Country in MENA (2010)

Saudi Arabia	41.4%	■
Egypt	9.4%	■
Qatar	8.1%	■
Lebanon	7.3%	■
United Arab Emirates	5.8%	■
Libya	5.6%	■
Iran	5.3%	■
Algeria	3.4%	■
Oman	3.0%	■
Others MENA	10.6%	■

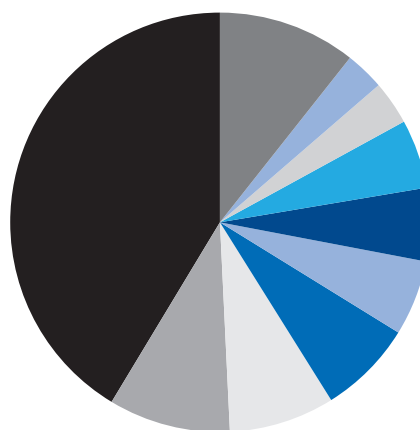
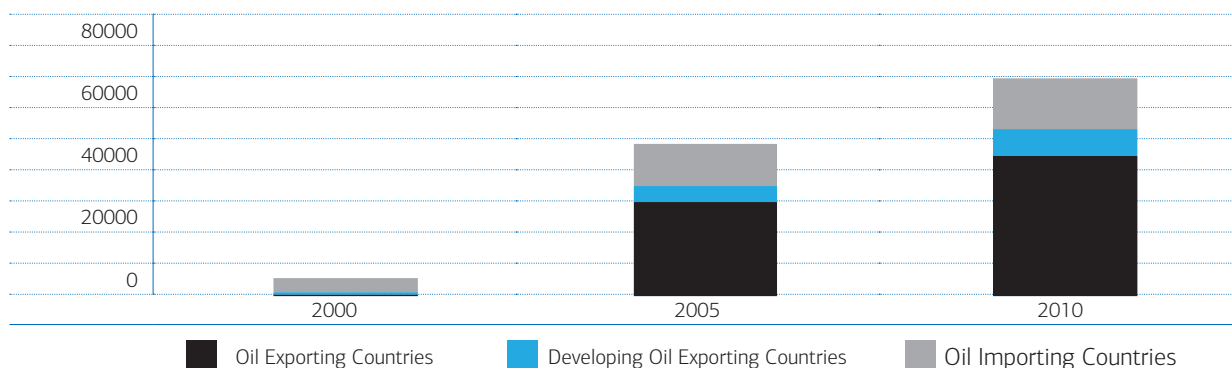


Figure 5: FDI Inflows by Country Types in MENA (2000, 2005, and 2010 in millions of current USD)



Source: UNCTAD

pected levels of foreign investment. While the large oil revenues in some ways acted as a substitute for FDI (they had large domestic savings to draw upon), in some of these countries, they effectively missed the economic contribution FDI often brings, such as jobs creation, technology transfer, and export diversification. The major reasons that explain the extensive gap in inward FDI performance between MENA countries comprise the pace of economic and investment reforms, the access to inexpensive production components (land, energy, and physical and human capital) and the integration into regional and global markets.

New trends in international FDI distribution by sectors show that FDI flows have expanded to new sectors such as electronics and computers, as well as air transport. However, in MENA countries, FDI was essentially concentrated in a few sectors with limited investment scope. Hence, until recently FDI was directed essentially to the hydrocarbon sector and other primary activities. This feature made FDI flows highly volatile in the region due to their vulnerability to commodity price change. Nonetheless, in the last years an important shift occurred for many MENA countries. A considerable proportion of the recent FDI flows to these countries have been in the form of greenfield investments, that is, a form of investment where a parent company directly creates or expands production capacities in a foreign

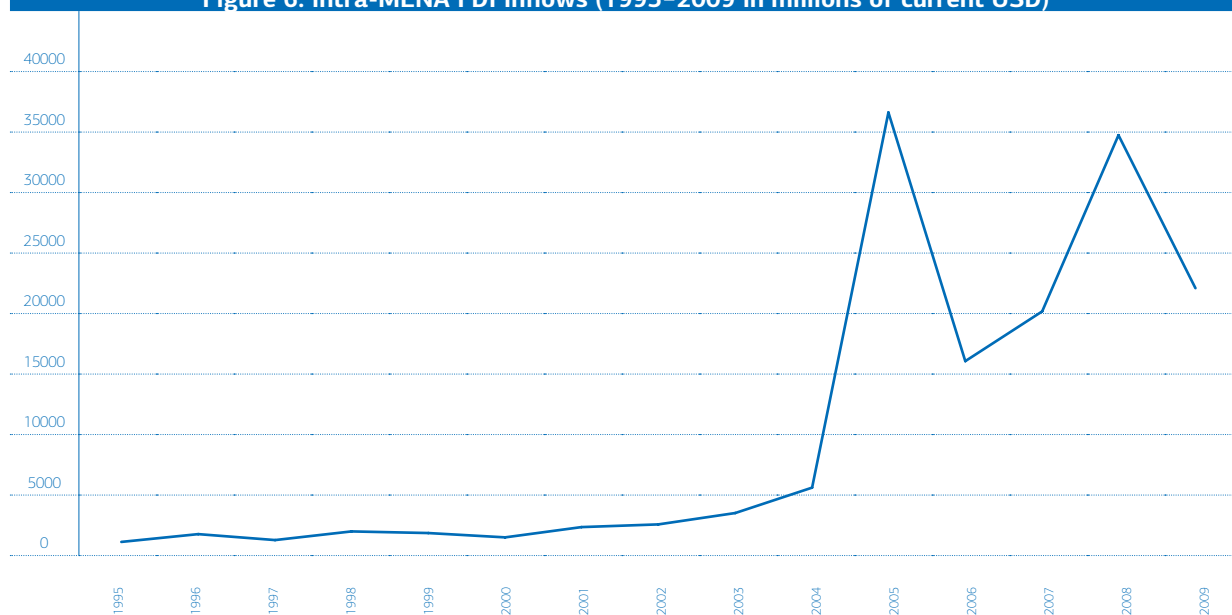
country by building a new plant. Greenfield investments are generally considered healthy for the FDI recipient country because it often involves a transfer of technology, managerial knowledge, and long-term job creation. Thus, sectors that captured large-scale FDI flows in countries like Saudi Arabia, Qatar, Libya, and Yemen include information and communications technology, banking and insurance, real estate, transportation, and tourism.

Outsourcing activities are expanding also in the region, especially in Morocco, Egypt, and Tunisia through the emergence of international call center. Indeed, North African countries seem well placed to take advantage of this phenomenon for linguistic, cultural-geographical, and low labor costs reasons. There are also cross-border mergers and acquisitions (M&A), in particular of privatized firms such as in telecommunications industries and banking. Between 1996 and 2010, more than 20 % of cumulative FDI flows to the region attributed to M&A.

More significant intra-MENA FDI flows

The most significant feature of FDI inflows in the MENA region is the growing importance of regional cross border investments. FDI has been at the core of regional economic integration since 2000. It has accelerated much more massively than trade, and is cross-cutting sub-

Figure 6: Intra-MENA FDI Inflows (1995–2009 in millions of current USD)



Source: The Arab Investment and Export Credit Guarantee Corporation

regions in a way that commerce has never managed (Hertog 2007). The growth has been particularly pronounced since 2005, but as it can be seen in Figure 6, it has been highly irregular, peaking at 34,808 million USD in 2005.

Fuelled by the massive surpluses in oil-producing countries during the last decade, much of it accumulated in sovereign wealth funds/ More than one third of FDI in the region was intra-MENA, which helps to explain, among other things, why the economies of non-oil states have also benefited from the boom. This phenomenon has been led not only by the regional sovereign wealth funds but more importantly by private Arab investors, who have displayed a growing predilection for regional projects¹. With large capital reserves, growing surpluses, and skepticism of Western

investment locations after 9/11, the gradually liberalizing region has gained new attractiveness for Gulf investors. Their asset allocation, by and large, is much more sophisticated than during the 1970s boom, as many of them have transformed from rentiers to entrepreneurs and take active interest in the projects in which they invest (Hertog 2007). This is not to say that regional investors do not face considerable hurdles in plowing their capital back into the region. Although gradually liberalizing, the governments of the MENA region have not changed overnight. Entrepreneurs have to face bureaucratic opacity, complex and outdated regulations, non-transparent licensing policies, judiciaries moving at a glacial pace and, frequently, outright corruption. Despite that, many mergers and acquisitions have been made within the region, especially in the banking and communications sector. In fact, many large Arab telecom companies, including Qtel (Qatar), Etisalat (United Arab Emirates), and Zain (Kuwait), faced with potential saturation and competition in their home markets, entered new markets. They have done so either by acquiring newly-issued mobile licenses or by

^{1/} Capital has also been recycled within the region through non-FDI channels, i.e. various forms of portfolio investment. These include a wide variety of usually Gulf-based investment funds active in infrastructure, energy, utilities or real estate projects, often benefiting from the region's governments' increasing willingness to draw on private capital to finance public functions. Recent years have also seen an emerging buyout and private equity industry in the region as well as smaller-scale venture capital funds.

taking over local operators. Besides these two sectors, Gulf investors have been particularly active in the relatively advanced Egyptian manufacturing sector and in real estate and touristic projects in several MENA countries. This last sector has the largest capital commitments but has been struggling since the beginning of the international financial crisis.

Despite this welcomed development, it is important to notice that intra-MENA FDI is very irregular and unequally distributed between countries and sectors (Laabas and Abdelmoula, 2008), which could have important consequences for the macroeconomic environment and the development path of the countries in the region.

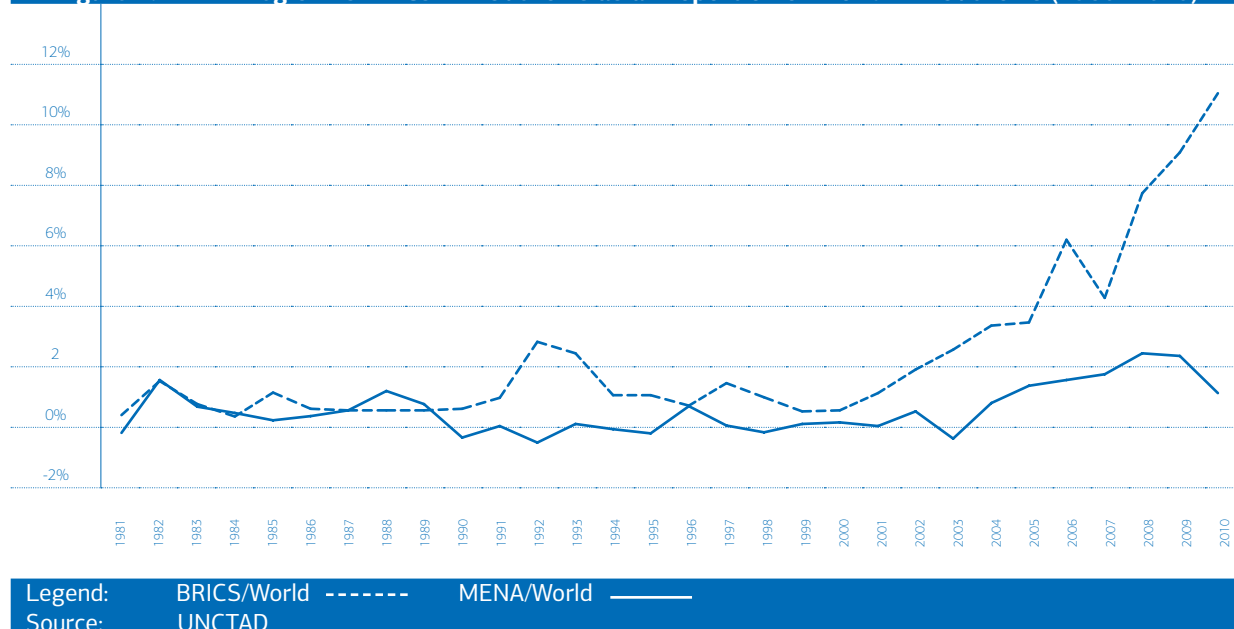
MENA is a Limited Source of FDI

If FDI inflows to MENA countries are still modest in comparison to world flows, FDI outflows from the MENA region are even less significant. Until 2003, FDI originating in the regions accounted for less than 0.5% of global FDI. In 2004, it jumped to 0.8% of global outflows, and it kept an increasing trajectory until 2008 and 2009, where it peaked at 2.4%. In 2010, they

collapsed, reaching only 1.1% of global FDI outflows (Figure 7). Until the 1980s, the MENA region had the same level of FDI outflows than the four BRIC countries taken together. However, since 1996 the trajectory has been divergent, showing the impressive growth of the BRIC countries as a source of FDI (see Depetris-Chauvin 2011 for details). In 2010, the four BRIC countries combined for USD 145.8 billion in FDI outflows (11% of world total) compared to USD 14.9 billion for the whole MENA region (approximately the same magnitude as that of India alone). Even at the peak of 2008, when the MENA region was the origin of USD 46.7 billion in FDI flows, that combined amount was lower than FDI outflows coming from Russia (USD 55.6 billion) and China (USD 52.2 billion).

Despite the fact that these FDI outflows have been modest at the global level, they are particularly important for some countries in the MENA region. As it was mentioned earlier, more than one third of these FDI outflows had another MENA country as a destination. Oil-importing countries in the MENA region such as Egypt, Morocco, Jordan, and Tunisia heavily depend on these intra-regional FDI flows to finance their infrastructure projects.

Figure 7: MENA Region vs BRICs FDI Outflows as a Proportion of World FDI Outflows (1980–2010)



Most of the FDI outflows in the region are concentrated among a few countries. In 2008, six countries (UAE, Kuwait, Qatar, Libya, Saudi Arabia, and Egypt) accounted for 91% of the FDI outflows in the region. The same six countries accounted for 83% of all FDI outflows in MENA in 2010 (Figure 8). Five of those six countries are leading oil exporters, and the expansion of their FDI can be interpreted as a natural consequence of the accumulation of financial resources generated by high oil prices coupled with the diversification strategies followed by their Sovereign Wealth Funds (SWFs). However, it is important to notice that a large portion of the FDI outflows in the MENA region were not due to the direct intervention of the SWFs but to government-controlled entities and private sector companies in telecommunication, banking, retail, and construction looking to expand their activities internationally in the face of domestic saturated markets. In general, the economic diversification policies of the Gulf countries has been pursued through a dual strategy: investing in other MENA countries to bolster their small domestic economies and also investing in developed countries to seek strategic assets for the development and diversification of the industrial capabilities back at home. Increasingly, this policy has been pursued with a view to creating productive capabilities that are missing at home, such as motor vehicles, alternative energies, electronics and aerospace. This approach differs from that of other countries, which have generally sought to develop a certain level of capacity at home before engaging in outward direct investment (UNCTAD 2011).

FDI Attraction Strategies in MENA

In recognition of the increasing importance played by FDI, most MENA countries have outlined a broad set of policies to attract foreign investors (see Depetris-Chauvin, 2012 for the case of UAE, Lebanon, and Tunisia). The strategies have been diverse, including a variety of policies, especially fiscal and financial incentives, investment promotion agencies, and free trade zones. Almost all MENA countries

have enacted new investment laws that enable foreigners to own companies in mostly all sectors of the economy. The intensification of competition with other countries and regions has pushed the region to adopt incentives in a "bidding war." Examples include Khalil and Yacoubi, 2010):

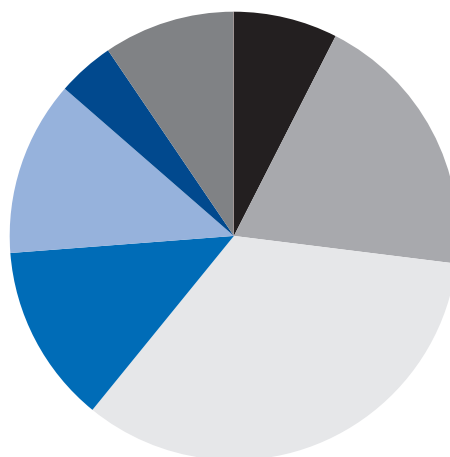
Fiscal incentives that include a tax holiday for a maximum period of 5 years in Syria to a period of 20 years in Egypt, depending on the sectors, or the reduction of corporate income tax, as in the case of Qatar, which reduced the maximum corporate tax rate from 35% to 30%, and Saudi Arabia, that cut the highest corporate income tax on foreign investment from 45% to 30%. There are also exemptions of indirect taxes in specific economic sectors like in the cases of Bahrain and Lebanon or in specific economic zones like in Egypt or Jordan. In Algeria, incentives are offered on a case-by-case basis after the approval of the National Investment Council, which can recommend indefinite tax holidays. Some other countries offer exemption of foreign personnel from income taxes and social security contributions, as it is the case of Jordan, or the exemption of reinvested profits from corporate taxation like in Tunisia.

Financial incentives targeted to some private companies to attract or encourage them to invest. This kind of incentive is justified by a need to compensate investors for the disadvantages of a particular location with low development or high unemployment. It may take the form of work infrastructure financing as in Algeria, or subsidizing the actual expenses of relocating corporate units like preferential rates on energy consumption such as in Saudi Arabia or the use of state-owned land at symbolic prices like in Tunisia.

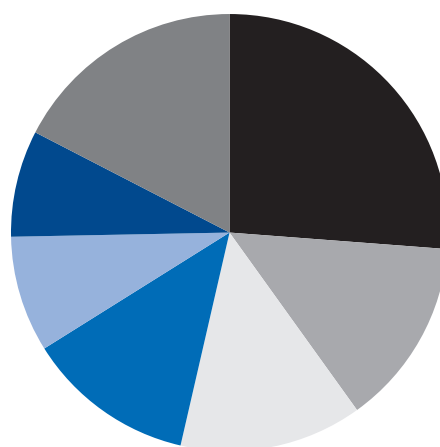
Free trade zones: According to OECD report (2007), all MENA countries have installed free zones except Algeria, Qatar and Saudi Arabia. The case of United Arab Emirates (UAE) is one of the most successful free zone experiences in the world. UAE launched several new free trade zones intended to establish the country as an international hub for trade. Tunisia, Morocco, and Egypt also installed free trade zones, although their success was mixed at best.

Figure 8: FDI Outflows by Country in MENA (2008 and 2010)

Saudi Arabia	8%	■
Kuwait	19%	■
United Arab Emirates	34%	■
Qatar	13%	■
Libya	13%	■
Egypt	4%	■
MENA Others	9%	■



Saudi Arabia	26%	■
Kuwait	14%	■
United Arab Emirates	14%	■
Qatar	12%	■
Libya	9%	■
Egypt	8%	■
MENA Others	17%	■



Investment Promotion Agency (IPA): MENA countries have created institutional structures to promote FDI attraction. The majority of these agencies set up a “one-stop shop” to deal with all of the foreign investor needs. Moves have been made by the majority of MENA countries to establish IPAs. Saudi Arabia established the associated investment authority (SAGIA), Algeria created the National Investment Development Agency and Egypt, the General Authority for Investment and Free Zones (GAFI) to facilitate FDI processing.

Overall, the evaluation of MENA countries strategies to capture FDI shows mixed results. Several surveys of investment drivers have proven that financial incentives rank lower in importance than factors such as political and economic steadiness, market access, and most critically, the ease of doing business. If the country is basically unstable, or if there is a high level of red tape, financial incentives will not counterbalance an adherence to free and open markets. Global investors have always attached greater importance to the economic

and political "fundamentals" than to incentives schemes. Therefore, it can be inefficient and costly for a government to offer investment incentives without ensuring an environment where it is relatively open and honest to conduct business. Most MENA countries are still clearly deficient in this area.



III. Assessing the impacts of FDI in MENA countries

FDI inflows play a pivotal role in economic growth of developing countries due to their potential in accelerating growth and economic transformation through capital stock accumulation and technological spillover and the improvement of employment conditions and infrastructure. The effects of cross-border activities bring an opportunity for the private sector in developing economies to tap into new markets, to access new technologies and resources, to spread risk, to reduce costs, and to increase competitiveness (Agosin, 2008). The economic gains to domestic consumers can be enormous, as local monopolies are erased and foreign competition brings lower prices and broader access to quality products and services. While some or many of the new jobs created by FDI may not seem to bring with it “ideal” working conditions and wages for the locals, employment gains are far greater than none. Given its enormous potential, we would like to carry a general assessment of the effect of FDI inflows in the MENA countries looking to its likely impact on growth, technological transfer, employment creation, trade, and infrastructure supply.

FDI and Growth: Positive but Weak Effect So Far

There are at least four key prerequisites for FDI to stimulate economic growth on the host country: (1) the existence of a stock of human capital that enables a domestic labor force to assimilate new technologies, (2) appropriate level of technology in host countries, (3) a level of financial sector development that allows foreign firms to upgrade their technologies, and (4) the openness to trade of the host economy as it facilitates technology transfer.

Research on the impact of FDI on economic development and growth in the MENA region are rare, mostly because of data constraints at the country level. Despite these limitations there are a few good studies. Overall, they find a positive but weak effect of FDI on growth in the MENA region. Most of the studies find that FDI absorption capacity in MENA countries is limited compared to that

of other developing countries. This could explain the feeble effects found of FDI on growth and productivity in the region (Sekkat, 2004). Bouklia and Zatlal (2001) also concluded that it is difficult to establish a positive and significant relation between FDI and economic growth in the region. Their study blames the limited human capital stocks as well as the effects of FDI crowding-out in domestic investments as the main reasons for the weak association between FDI and growth. Korgstump and Matter (2005) looks at FDI and growth through absorptive capacity in the MENA region using available data on four different aspects of absorptive capacity: the technology gap, the level of workforce education, financial development, and institutional quality. Their conclusion is that it is unlikely that the average Arab country currently stands to gain from FDIs, given their level of absorptive capacity. Kandil and Mirzaie (2009) find that FDI flows stimulate real output growth only in Jordan in a sample of MENA countries.

Limited Technology Transfer

FDI is considered as one of the most important drivers of international transfer of technology and know-how. Technology is vital for economic growth, leading to capital accumulation, improvements in trade, and changes in the organization of social and production relations. Technology transfer takes place via technical assistance to suppliers and customers, demonstration effects on local firms in the choice of technology, managerial practices, as well as accessing to international marketing networks.

While empirical studies confirm that developing countries attracting more FDI are in a better position to develop a strong manufacturing industry and export performance, and that

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they have enhanced their integration into international production networks, FDI does not appear to have had that effect in most MENA countries. Sadik and Bolbol (2001) studied the effect of FDI on total factor productivity through technology spillovers in Morocco, Jordan, Egypt, Saudi Arabia, Jordan, Oman, and Tunisia over a 20-year period from 1978 to 1998. They discovered that FDI has not had any noticeable positive spillovers on technology and productivity. This surprising result can be explained by the nature of some FDI concentrated in low technology sectors like textiles, extraction of some natural resources, and real estate.

For some countries, particularly in the Gulf, the majority of the labor force is composed of foreigners generally concentrated in either the technical occupations or in low-skilled labor, while the indigenous population is concentrated in either the managerial positions with foreign assistants or in the service occupations outside of the production process where technology use is intense. While foreign workers provide enormous economic benefits for the labor-importing countries of the Gulf, these countries remain heavily dependent on foreign labor in sectors and occupations critical for technology transfer. This situation leads to low technology absorption among nationals and affects the degree of knowledge nationalization. The other explanation for the low technology absorption is that a large bulk of the work force in MENA countries is composed of young people and adults who have only completed primary education and do not have training that would qualify them to fill jobs with tertiary or technical educational requirements.

In FDI recipient countries like Tunisia, Morocco, and Egypt, multinational companies only bring to each country a small component of the technology linked to the fabrication of the whole product as a strategy to deliberately limit technology transfer. This is, for instance, the case of Tunisia, where multinationals produce only some car electronic parts. In addition, export-based industries limit technology transfer because the relation between local firms and multinational firms is limited.

FDI and Employment Creation: Ambiguous Impact Due to Skill Gap and Labor Market Distortions

Despite the potential impact of FDI in jobs creation in a region with high unemployment rates among the youth, MENA countries lack thorough studies assessing the impact of FDI on employment. The data dearth and limited capabilities often do not allow governments in the region to formulate suitable promotion policies toward more FDI attraction that could have a positive impact in employment. However, even when FDI projects take place, they are incapable of absorbing new graduates, as often they lack the right set of skills.

In one of the rare studies on the subject, Massoud (2008) shows that FDI does not exert a positive impact on employment in Egypt. The research claims that this is because FDI has different components: Greenfield FDI and M&A. These different constituents have diverse and even contradicting impacts. Greenfield and Manufacturing FDI produced a positive outcome on employment, particularly when they were correlated with the level of human capital and exports, while FDI in privatization, agriculture, and services had negative direct effect and insignificant interactive effects because the majority of these investments diminished the number of workers due to gains in productivity and a switch to more capital intensive production methods.

In the case of Tunisia, FDI projects are concentrated in labor-intensive sectors such as textile that generates about 58% of total FDI jobs. However the textile industry cannot employ university graduates who represent the major element of unemployed (with the exception of managerial positions). This, of course, is not the market failure of FDI but the failure of the state-run educational system in Tunisia.

While there are no studies on the effect of FDI on employment in the Gulf States (where the composition of the labor force is very different than in the MENA oil-importing countries), there is strong anecdotal evidence that FDI creates few jobs among the local population, given their very strong preference for job security pro-

vided by the public sector. In most of the Gulf States, like Kuwait, Qatar, and the UAE, at least 90% of the nationals employed work for the state.

FDI Targeting Non-tradable Sectors May Explain Low Impact on Exports

While FDI is often thought of as a substitute for trade, the reality is that FDI can both substitute and complement trade. According to the abundant literature on the subject, trade and FDI are inter-related and positively influence each other. In fact, trade and foreign exchange liberalization increase FDI and, inversely, inflows of FDI increase the volume of trade and exports (Sekkat and Veganzones, 2004).

For the MENA countries, many authors explain the low GDP growth rates by the lack of exploiting its full potential in terms of trade and FDI (Iqbal and Nabli, 2007). Studies show that abstracting from oil, the region scores one of the lowest ratios of exports to GDP among all regions of the World but Sub-Saharan Africa. It also has the lowest ratios of FDI to GDP among all regions of the World (Sekkat and Veganzones, 2004). This poor performance is

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explained by prolonged application of inward-looking strategies based on import-substitution (Nabli and De Kleine 2000). That is why since the 1980s, many MENA countries have undertaken economic reforms in order to open their markets, lower the trade barriers and privatize many State-owned industries as well as reforming the foreign-exchange market. Nonetheless, some other countries are still lagging behind.

Though the bulk of the FDI inflows to MENA countries in the last decade has target-

ed non-tradable sectors such as retail, banking, communication, and real estate, and therefore no immediate response of trade should be expected, part of these foreign investments are in sectors that would contribute to the physical and soft infrastructure that is prerequisite for successful export performance.

Positive Effect on Infrastructure Development

As with trade, the relationship between FDI and infrastructure is bidirectional. FDI often enhances improvements in local infrastructure, but at the same time infrastructure availability is an important determinant of countries' attractiveness for FDI inflows, especially for multinational companies seeking strategic locations to feed global markets. For foreign investors, infrastructure facilities raise the rate of return by subsidizing the cost of total investment and thus contribute to the improvement of the investment climate.

Infrastructure availability is hard to measure. Kumar (2001) makes an attempt in an index that combines transport infrastructure, telecommunications infrastructure, information infrastructure, and energy availability, among others. In that index computed for 66 countries, the MENA countries ranked were Bahrain (9th), Kuwait (21st), Saudi Arabia (33th), Libya (39th), and Egypt (53rd). In general terms, Gulf countries have a state-of-the-art infrastructure, while oil-importing

MENA countries are lagging behind. In the last few years, some of the largest FDI projects in the MENA region, especially intra-MENA FDI flows, have targeted ports, airports, communication, and the financial sector what should contribute with an overall positive impact to the level of available infrastructure of these countries.

IV. FDI Perspective and Remaining Policy Challenges



FDI flows have been increasing rapidly in recent years in the region, and especially between MENA countries, due to legal and macroeconomic framework improvement, lower entry barriers, and to the new opportunities created by the economic transformation of several of the oil-rich economies. The competitiveness of most MENA countries covered by the Global Competitiveness Index shows a robust upward trend. Record oil prices coupled with sound policies over the past few years have buoyed economic growth across the Middle East and North Africa region. Business environment reforms, investment in infrastructure, and targeted diversification are now paying off in many countries through higher competitiveness rankings. The rising energy prices have benefited not only the hydrocarbon exporters, but have also generated spillover effects throughout the entire region through increasing intraregional FDI.

Increased FDI inflows reflect increased local and international confidence in MENA economies in the course of the recent oil boom and the way it is being managed different from the last boom, which led to a rapid expansion of imports and the service sectors, but an outflow of capital (Hertog 2006). The last decade has brought heightened international interest in the Gulf economies in particular, as extra-regional institutional investors and industrial players are slowly moving into markets that have seen a progressive erosion of national privileges and investment restrictions since the late 1990s. The new pattern of capital recycling reflects a larger regional shift in business capacities. Although some regional champions are also emerging outside of the GCC (notably Egypt's Orascom Telecom), most of the largest Arab investment consortia and companies are now located in the Gulf. Led by the GCC countries, the region has also become an incipient source of FDI. Arab governments outside the Gulf have been actively soliciting FDI from the GCC. New bilateral investment offices have been opened in the Gulf, large conferences for Gulf investors held, and privatization initiatives are announced with a specific view

to attracting Gulf capital. A healthy competition for Gulf capital has started — a process in which business tends to drive politics rather than the other way round.

The positive trend in FDI inflows and outflows in the MENA region was interrupted by the international financial crisis. The fall in FDI inflows in 2010 varied by country. For example, they dropped by 12% in Saudi Arabia, where a number of flagship megaprojects in the petrochemical industry involving joint ventures saw the withdrawal of foreign partners or were temporarily frozen or failed to attract enough foreign investment. In Qatar, FDI inflows fell by 32% as the last of four LNG Qatargas plants, which had been bolstering FDI in that country, was completed in 2010. In the United Arab Emirates, FDI stayed at the same low level as in 2009, when it had plummeted to \$4 billion due to the financial implosion of Dubai, whose unexpected default on its debt was eventually covered by its oil rich cousin Abu Dhabi. Outflows from major investors in the Gulf also fell significantly, due to large-scale divestments and redirection of outward FDI from government-controlled entities to support their home economies weakened by the global financial crisis.

Of course, the 800-pound gorilla in the room affecting not only future FDI flows but the region's economic perspectives is the enormous concerns about political stability. The outcome of this "Arab Spring," whether it results in free market democracy or more authoritarian regimes, will ultimately determine whether the MENA region (particularly outside the GCC), is heading. For the short run, however, FDI flows, moving in both directions,

The outcome of this "Arab Spring," whether it results in free market democracy or more authoritarian regimes, will ultimately determine whether the MENA region is heading

World Bank – Ease of Doing Business Ranking 2012 (out of 185 countries)

Country	Ranking
Saudi Arabia	22
UAE	26
Qatar	40
Bahrain	42
Tunisia	50
Kuwait	82
Morocco	97
Jordan	106
Egypt	109
Lebanon	115
Yemen	118
Syria	144
Algeria	152
Iraq	165

Note: Economies are ranked on their ease of doing business, from 1 – 185. A high ranking on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm.

are likely to be muted until some semblance of stability returns to the region.

Away from the particularities of the current economic and political situation, it is important to signal that there is still a wide gap between the FDI flows in the rest of the world and the MENA region potential. Despite the successive reforms, international comparisons suggest that the MENA region lags most other regions in regard to investment climate considerations. The region tends to have relatively high transaction costs for starting, operating and closing businesses what may have a negative impact on FDI flows.

The fact remains that outside the GCC, the MENA region is not an easy place to do business. Over half of the MENA countries are currently ranked in the bottom half in the ease of doing business. Before the issue of attracting more FDI into the region, which is greatly needed, all the structural issues that make doing business on a day-to-day level difficult (if not impossible), must first be addressed. The revolutions that have recently rocked this region in the past two years can link its direct causes to these very problems.

The main policy implications of this study are that if MENA countries were to maximize the positive effects of FDI in their economies, they should (i) continue to improve their policy environment, reduce macroeconomic instability, and develop their financial systems; (ii) reduce the size of the government by implementing privatization programs that would reduce red tape and corruption and at the same time open economic sectors dominated by the State to foreign investors; and (iii) undertake deep reforms of educational and vocational training systems and promote local human capital accumulation. Without addressing these structural issues, the costly financial incentives to attract more FDI will be insufficient, and the region will miss the chance to tap a favorable international context where the shift of FDI to emerging markets continues to gather pace.



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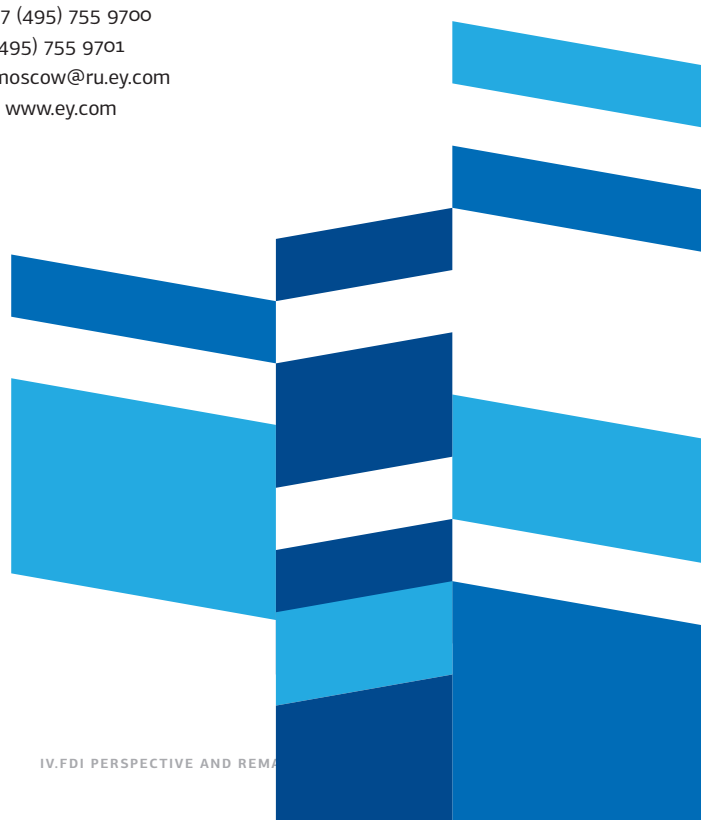


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