Strategic Sectors | **Economy and Territory**

Investment in Turbulent Times: How Political Turbulence Has Affected the FDI Level in the MENA Region

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At the onset of the 2008 global financial crisis, Mediterranean countries[1] were facing important internal and external economic changes that enhanced their growth prospects. Integration in the global economy and trade liberalisation, reforms of the exchange rate systems and progress with the regional integration processes were paving the way to more diversified production and export structures. A transition had begun from planned and state-dominated economies to market economies with the privatisation of many public companies. Moreover, the boom of the Gulf states' economies[2] had produced investment spillovers of their oil rents in the region, and the region's role as a logistics hub and export platform for entering new investment areas in Africa and Asia was reinforced.

Against this changed economic background, FDI flows to the region, which started out quite low, began to increase in the early 2000s, peaking in the second half of the decade, by which point they accounted for a major share of the foreign capital flow to the region. However, global financial and economic turbulence and, later, internal political turmoil caused FDI to drop in 2009, marking the end of the very short investment wave that occurred between 2004 and 2008. Whereas the rest of the world's FDI picked up after 2010, FDI flows to the MENA region continued to decline as economic and political conditions worsened. While the 2009 collapse was not too dramatic, thanks to the region's poor financial development and the positive spillovers of the Gulf countries' increased government spending, the two crises that hit the region later, related to the eurozone countries' sovereign deficits and the events of the Arab Springs, blocked the virtual processes and deeply affected FDI growth in 2011, 2012 and 2013. Governments were overthrown in the Arab Republic of Egypt, Tunisia, Libya, and the Republic of Yemen; civil wars broke out in Libya and the Syrian Arab Republic; and major turmoil spread throughout Bahrain, Jordan, Turkey and Lebanon. These events led to an erosion of institutional quality, but also to a worsening of macroeconomic stability, poor economic performance and serious detrimental effects on FDI. The MENA region's share of global FDI flows, which had doubled between the 1990s and 2000s, retreated to 1990s' levels. While political instability has had an impact on all investors, evidence suggests that it has had a greater impact on multinational corporations operating in the region.

The regional outlook for 2014 is marked by uncertainty and subject to a variety of risks, mostly domestic in nature and linked to high policy uncertainty, which has become a key concern for investors and the most severe constraint to doing business in the Middle East and North Africa (World Bank, 2013).

In the following pages, we will briefly describe FDI in the Mediterranean countries, focusing on the links between political factors and trends and FDI patterns at the global, European and intraregional level. Additionally, we will try to determine the sector composi-

[1] For the purposes of this article, the Mediterranean countries, or MED11, include the Maghreb countries (Algeria, Libya, Morocco and Tunisia), the Mashreq countries (Jordan, Lebanon, Syria, and the Occupied Palestinian Territory), Israel, Egypt, and Turkey. When we refer to the Middle Eastern and North African (MENA) economies, we are considering all MED11 countries, except for Israel and Turkey, as well as Iraq, Iran, Yemen and Djibouti.

[2] The Gulf Cooperation Countries (GCCs), or Gulf States, are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

tion of FDI in the region and whether there is any hint of "higher-quality FDI," i.e., diversification from natural-resource-based investment towards investment in manufacturing and more qualified and technology-intensive goods and services able to produce higher spillover effects in the region and enhance its growth potential. In the aftermath of the political crises, the picture we get suggests a strong heterogeneity in the national patterns of FDI collapse and revival and important changes in investor involvement, but also a strong overall persistence in terms of the sectoral FDI composition.

Foreign Investment Performance and Challenges Posed by the Arab Transitions

The participation of MENA countries in global FDI has been conditioned by their specialisation model, which is mostly based on three economic activities strongly affected by volatility and cyclical trends: resource-based activities such as agriculture and oil, manufacturing, and tourism (Diop et al., 2013). In spite of the efforts to improve trade integration and the tough macroeconomic reforms carried out in the 1990s, MENA countries are still not fully taking part in the

TABLE 13 **Inward Foreign Direct Investment Flows (as percentage of world total, 1980-2012)**

YEAR	1980	1985	1990	1995	2000	2005	2007	2008	2009	2010	2011	2012
MENA countries	***0.51***	***2.64***	***0.38***	***0.33***	***0.37***	***2.02***	***1.65***	***1.93***	***2.55***	***1.88***	***1.04***	***1.72***
Algeria	0.64	0.00	0.02		0.02	0.11	0.08	0.14	0.23	0.16	0.16	0.11
Egypt	1.01	2.11	0.35	0.17	0.09	0.54	0.58	0.52	0.55	0.45	-0.03	0.21
Jordan	0.06	0.04	0.02	0.00	0.06	0.20	0.13	0.16	0.20	0.12	0.09	0.10
Lebanon	-0.02	0.01	0.00	0.01	0.07	0.34	0.17	0.24	0.39	0.30	0.21	0.28
Libya	-2.01	0.21	0.08	-0.03	0.01	0.10	0.19	0.18	0.27	0.14		
Mauritania	0.05	0.01	0.00	0.00	0.00	0.08	0.01	0.02	0.00	0.01	0.04	0.09
Morocco	0.17	0.04	0.08	0.10	0.03	0.17	0.14	0.14	0.16	0.11	0.16	0.21
Syrian Arab Republic	0.00	0.03	0.02	0.02	0.02	0.06	0.06	0.08	0.21	0.10		
Tunisia	0.46	0.25	0.04	0.11	0.06	0.08	0.08	0.15	0.14	0.11	0.07	0.14
Iran (Islamic Republic of)	0.15	-0.07	-0.17	0.00	0.01	0.32	0.10	0.11	0.25	0.26	0.25	0.36
Iraq	0.00	0.00	0.00	0.00	0.00	0.05	0.05	0.10	0.13	0.10	0.13	0.19
Djibouti	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.01	0.01	0.00	0.00	0.01
Yemen			-0.06	-0.06	0.00	-0.03	0.05	0.09	0.01	0.01	-0.03	0.03
Turkey	0.02	0.20	0.07	0.46	0.49	0.49	0.44	0.60	0.38	0.39	0.67	0.77
Israel	0.03	0.18	0.33	0.26	0.07	1.01	1.10	1.09	0.71	0.64	0.97	0.92
Gulf Cooperation Council	***-6.29***	***0.98***	***0.08***	***0.45***	***0.03***	***2.86***	***2.42***	***3.40***	***4.23***	***2.93***	***1.59***	***1.95***
Bahrain	-0.77	0.18	-0.09	0.13	0.03	0.11	0.09	0.10	0.02	0.01	0.05	0.07
Kuwait	0.00	0.01	0.00	0.00	0.00	0.02	0.01	0.00	0.09	0.03	0.05	0.14
Oman	0.18	0.29	0.07	0.01	0.01	0.16	0.17	0.16	0.12	0.09	0.04	0.11
Qatar	0.02	0.01	0.00	0.03	0.02	0.25	0.23	0.21	0.67	0.33	-0.01	0.02
Saudi Arabia	-5.90	0.88	0.15	0.17	0.01	1.22	1.21	2.17	3.00	2.08	0.99	0.90
United Arab Emirates	0.18	-0.40	-0.06	0.12	-0.04	1.10	0.71	0.76	0.33	0.39	0.46	0.71
Transition economies excluding the Russian Federation	0.04	0.03	0.04	0.59	0.31	1.83	1.82	2.57	2.97	2.26	2.50	2.66
Russian Federation				0.60	0.19	1.57	2.85	4.12	3.01	3.06	3.34	3.81
Southern Asia excluding India	0.38	0.05	-0.01	0.19	0.09	0.69	0.46	0.52	0.56	0.54	0.49	0.59
India	0.15	0.19	0.11	0.63	0.25	0.77	1.27	2.60	2.93	1.50	2.19	1.89
Eastern and South-Eastern Asia excluding China	6.51	4.70	8.75	11.12	7.60	9.47	8.35	7.58	9.48	14.04	13.25	15.18
China	0.11	3.50	1.68	10.92	2.88	7.32	4.17	5.96	7.81	8.15	7.51	8.96
South America excluding Brazil	2.98	4.09	1.95	4.14	1.72	2.93	1.85	2.66	2.53	3.10	3.80	5.86
Brazil	3.53	2.54	0.48	1.28	2.32	1.52	1.73	2.48	2.13	3.44	4.04	4.83
Developing economies	13.81	25.37	16.76	34.04	18.72	33.80	29.43	36.80	43.59	45.23	44.52	52.03

Source: Own elaboration using UNCTAD data, accessed on March 2014.

development of global production networks or the new potential of integration in global markets (Giovannetti, 2013). Moreover, they do not constitute an integrated economic space yet, despite the many intra-regional agreements that have been signed since the 1960s (Romagnoli and Mengoni, 2013).[3] The pace of FDI growth in the MENA region (below 2% on average) lags far behind that of many other emerging economies, such as China (which rose from a share of less than 1% in 1980 to more than 9% in 2012), South and East Asia (up from 6% to more than 15% over the same period), and Central and Eastern Europe and the Russian Federation (climbing to more than 6% in 2012 from virtually zero in 1995) (see Table 13).

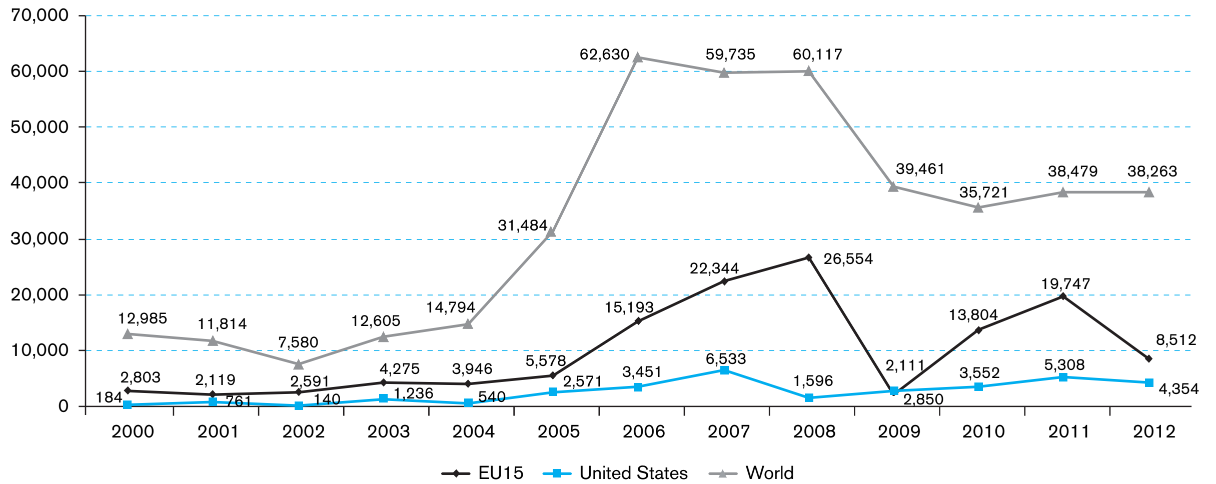
FDI in the MENA region tends to focus on countries with greater political stability and more favourable economic factors (rapid privatisation, deregulation and liberalisation of financial markets and trade). On the other hand, a crucial factor for localisation is a country's oil resources (Sekkat, 2012). In the Maghreb region, flows are concentrated in Morocco, for reasons of stability, and Algeria, where they are almost entirely invested in the oil industry and its supplier and user sectors. In the Mashreq, the main destinations are Israel, Egypt and, before the conflict, Syria. Since 2005, large inflows of FDI into the GCC economies have also predominated (see Table 13).

Chart 25 shows the level of FDI inflows to MED11 countries over 2000-2012. Total investment increased from less than $13 million to more than $38 million at its peak in 2006. It then dropped 30% in 2009, and the ensuing political turmoil that took place in 2011 and 2012 undermined FDI recovery in the region.

The Arab transitions generated a substantial shock to political stability, reflected in significantly deteriorated political risk rankings in almost all countries in the region. Many countries have been experiencing political turmoil since 2010 in terms of government changes, conflicts, and policy instability, with major effects on the business and legal environment.

We used the political stability index from the World Bank's governance indicators for 2010-2012 to check whether investors were discouraged by the deterioration in the political and economic environment in the region after 2010. Chart 26 shows the results. In general, increased political instability in the host economy was directly correlated with decreased FDI in MENA countries, although there were some exceptions.[4] Tunisia, Morocco, Yemen and Turkey saw positive growth in FDI, despite serious declines in political stability.[5] The

CHART 25 **Foreign Direct Investment Flows to MED11 Countries by Source Region: World, USA and EU15 (1980-2012, in US$ million)**



Source: Own elaboration based on OECD (EU15, United States) and UNCTAD (World) data, accessed on March 2014.

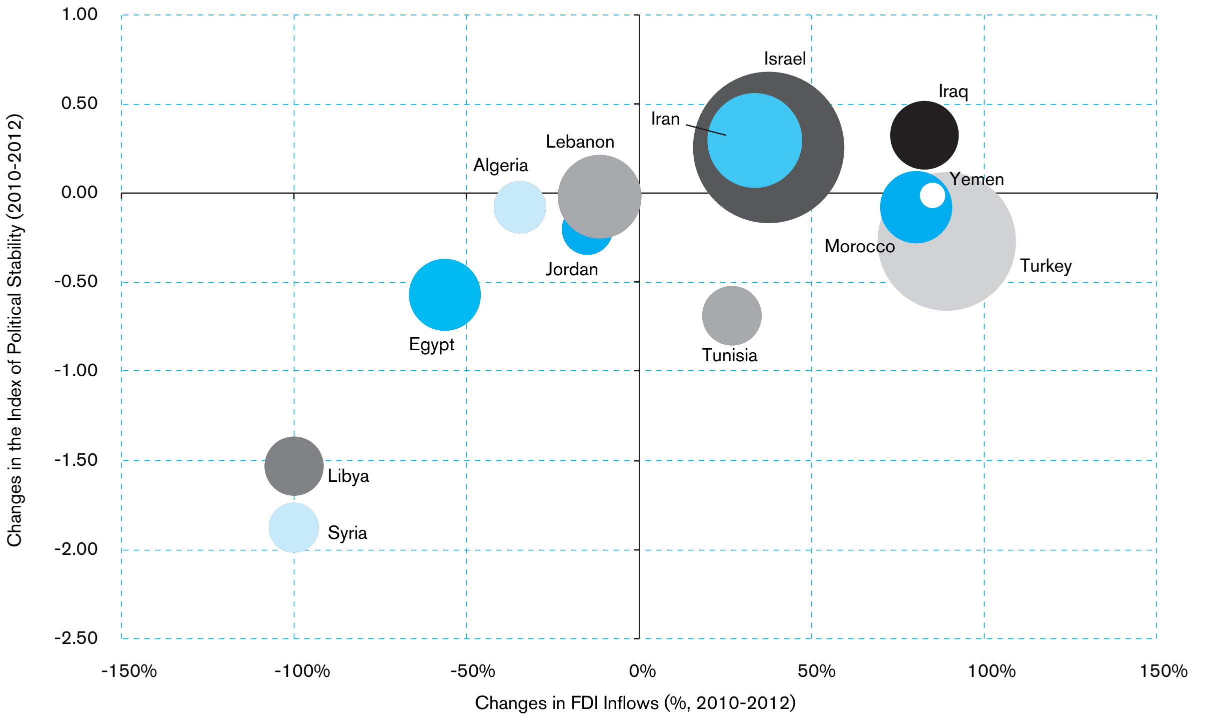
[3] The Arab Common Market in 1964, the Gulf Cooperation Council in 1981, the Maghreb Arab Union in 1989, the GAFTA in 1997, and the Agadir Agrement in 2004.

[4] A similar relationship was tested with econometric estimates by Burger, Ianchovichina and Rijkers (2013).

[5] In Tunisia, the decline in FDI rates was small, despite the political turmoil due to Tunisia's dual economy structure, under which investment in the offshore sector is tax-exempt and subject to few regulations. Morocco experienced a significant rise in 2012 due to the less serious nature of the unrest experienced in the country.

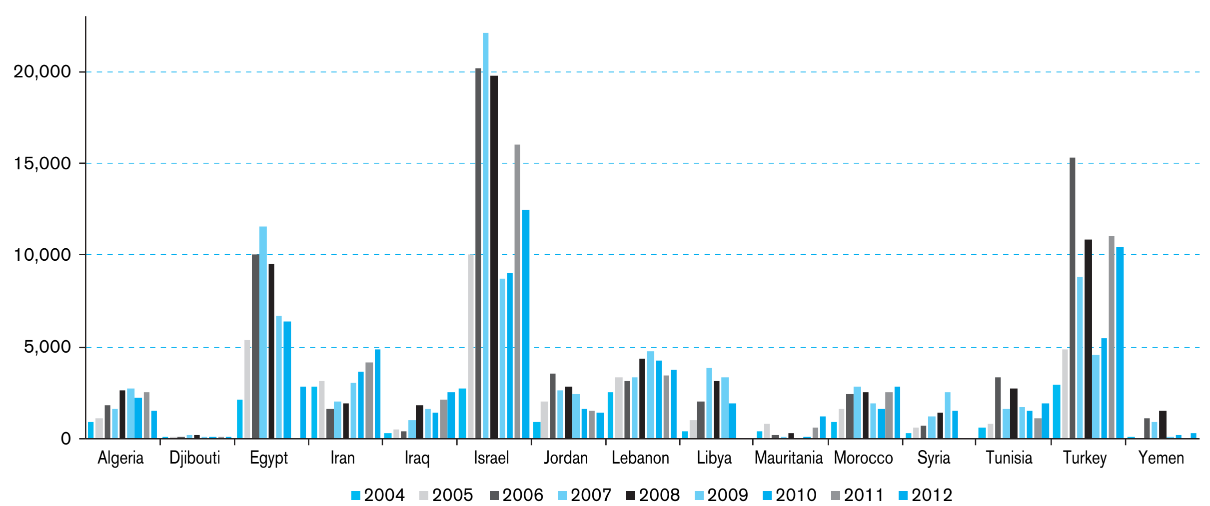
countries registering the most serious losses in terms of both political stability and FDI inflows were Syria, Libya, Egypt, Algeria and Jordan. No FDI increase was registered in Syria over 2012, and investors did not return to Libya until 2012. Three years after peaking at $11.6 billion and subsequently collapsing to $6.7 billion in 2009, FDI in Egypt had still not recovered, due to the critical political and security situation. Jordan likewise remained in a critical situation in 2012, due, among other things, to the adoption of a rigid fixed exchange rate regime anchored to the dollar. In Israel, after reaching the record figure of $20 billion in 2006, FDI fell to less than $8 billion dollars in 2009 and, by

CHART 26 **Changes in Inward Foreign Direct Investment Flows by MENA Destination Country vs Changes in Political Stability (%, 2004-2012)**



Source: UNCTAD data and World Bank Governance Indicators, accessed in March 2014. The size of the circle reflects the country's share in world FDI inflows.

CHART 27 **Inward Foreign Direct Investment Flows by Destination Country (in US$ million, 2004-2012)**



Source: Own elaboration based on UNCTAD data, accessed in March 2014.

2012, had rebounded to only $13 billion. In contrast, in Lebanon, FDI was generally quite resilient, given the country's proximity to the conflicts in Syria.

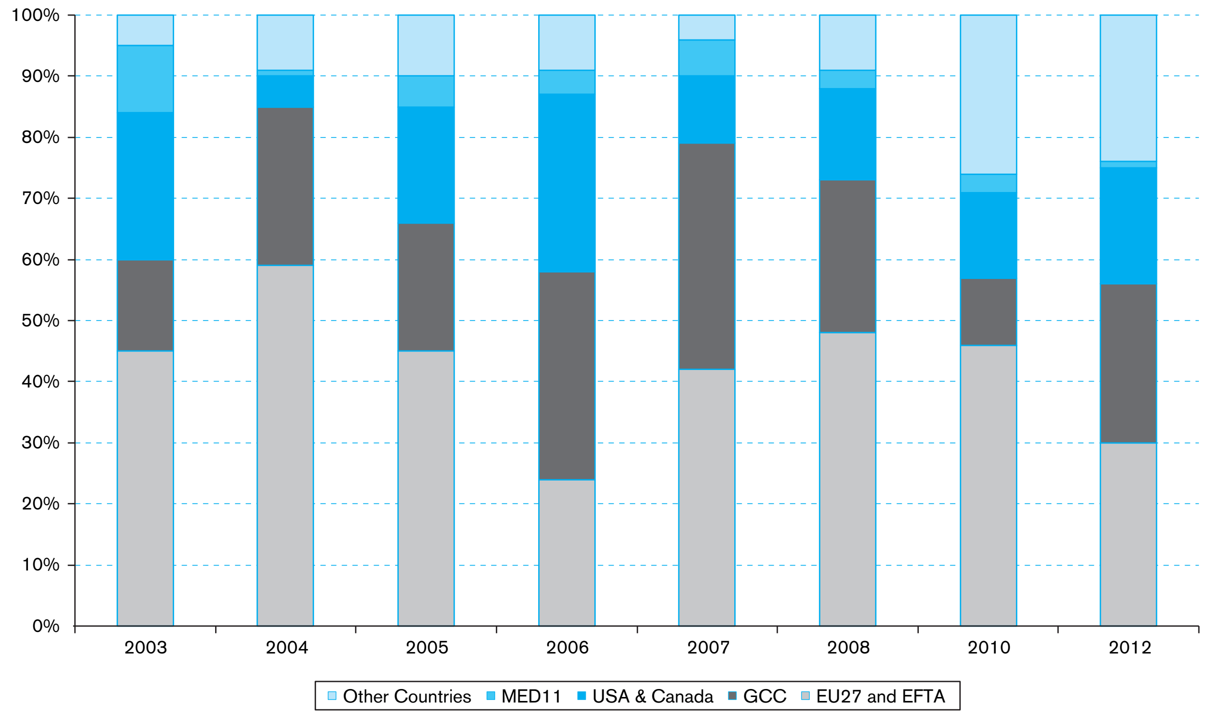
Emerging Actors and Intra-Arab Investment

A crucial change in the geographical map of FDI has occurred over the last decade with the emergence of new investors (Chart 28). With the enormous surplus in the oil-rich Gulf economies, converted into sovereign funds, intra-Arab FDI from the GCC countries increased sharply between 2004 and 2008, rivalling the EU for leadership in the region and compensating for the loss of American investors. The improved positions of China and other Asian and emerging countries, such as Brazil and Russia, were likewise remarkable.
The political uprisings in the region have further reinforced emerging countries' rise and the slowdown in Western investors from the EU and US. Investment flows from the US have decreased in all countries in the region, especially Egypt and Tunisia. Conversely, the Gulf States have strengthened their support for the news Islamist governments in Northern Africa and, at the same time, have emerged from the financial crisis that affected the Gulf monarchies between 2007 and 2011. In contrast, the EU15 region, the main trade partner and investor, has lost relevance in the region since 2007, dropping from over 40% of total FDI in 2008 to only 21% in 2012. However, this slowdown may be cyclical, due to a loss of confidence by EU investors, and it could reflect the "wait and see" attitude of EU governments with regard to the new political leaders to emerge in the region. Many Mediterranean countries will revise their development and governance models, and this will most likely lead to increased investment from Europe in the near future. Intra-MED11 investment also remained very low and was further weakened over the crisis, although the changes taking place in the region should also lead to greater political and economic intra-regional integration in coming years (Noutary and Louçon, 2013).

Patterns of FDI by Sector

The wave of increasing FDI over the last decade fuelled by the oil boom was dominated by large inflows

CHART 28 **Outward FDI Flow Positions in MED11 Countries by Main Region (% total inflows, 2003-2012)**

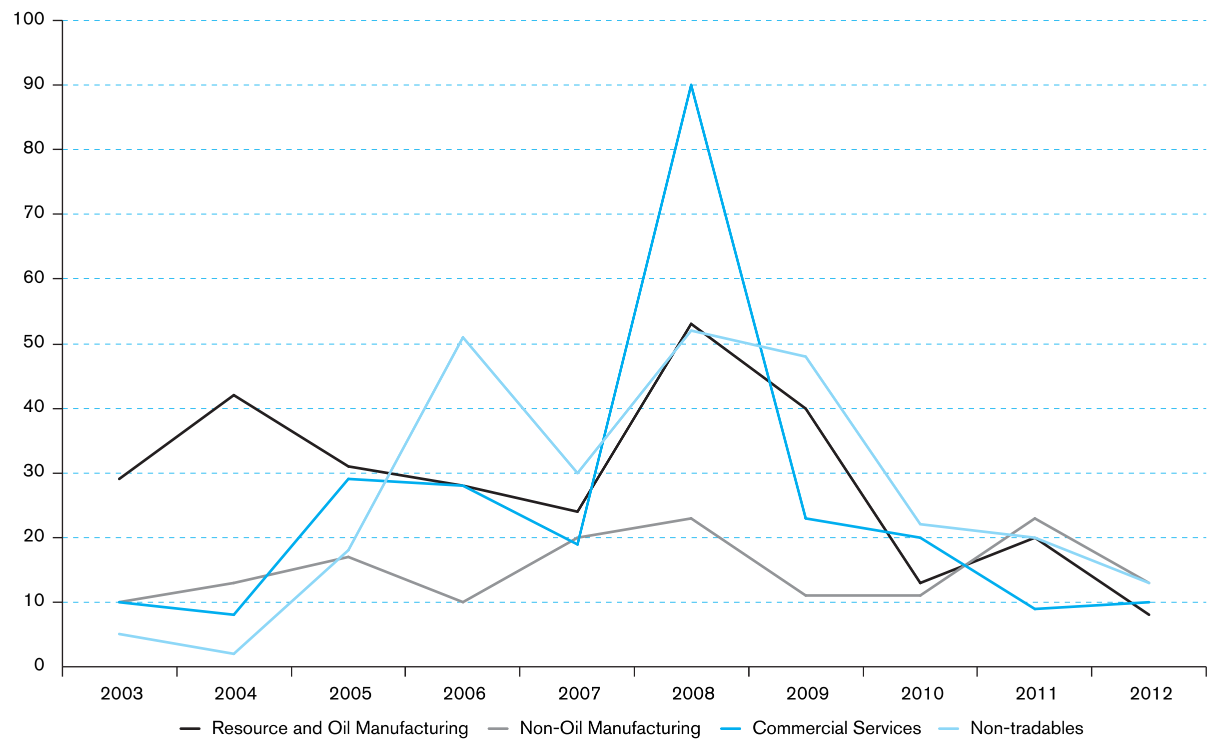


Source: ANIMA-MIPO 2003-12.

of FDI in natural resources and non-tradable activities (Chart 29). There was a shift in the destination of FDI from MENA countries' developing oil importers, which received over 60% of all net FDI inflows to the region between 1993 and 1997, to the region's oil exporters, which received almost two thirds of FDI inflows between 2003 and 2007 (World Bank, 2013). Since the post-2011 collapse, this skewed composition has grown even worse, as the need for democratic reforms dampens certain investment flows, causing sectoral shifts similar to those seen with Dutch disease. While foreign investors in natural-resource-intensive and non-tradable sectors appear to be quite resilient to shocks to political stability for several reasons, including, simply, the geographically constrained availability of natural resources, which has decreased significantly over the past few decades, political instability has a strong negative effect on investment in non-resource tradable manufacturing and tradable service activities.[6] Of the 50 largest multinational firms doing greenfield investment in the MENA region, as reflected by FDI market data for 2012, nearly half operate in resource and oil manufacturing sectors and only 12 are engaged in tradable non-oil activities, of which ten invest in commercial services, while only two invest primarily in non-oil manufacturing. The traditional sectors of utilities, such as energy, telecoms, banking, construction and public works have continued to attract the bulk of FDI, a pattern that has only been strengthened by the revival of the Gulf Countries' position in the area (World Bank, 2013).

In the near future, an additional gain in the GCC countries' position might further reduce the rate of increase for investment in more tech-intensive sectors, which are mainly linked to Western investors. Therefore, political unrest might amplify the effect of FDI clustering in traditional sectors such as oil renting and labour-intensive and non-tradable sectors, reducing the chance of investment in the types of high-quality, non-resource-intensive activities that

CHART 29 **Greenfield FDI Flows to the MENA Region by Sector (US$ Billion)**



Source: FDI market data from the World Bank, 2013.

[6] However, not all types of political instability matter equally to the MENA region's foreign investors. Government instability, worsening bureaucratic quality, an unstable business environment, and conflicts have a strong negative effect on foreign investment, whereas other aspects of political instability, such as the lack of democratic accountability or law and order, corruption, and ethnic and religious tensions, seem to matter less (World Bank, 2013).

are essential to increasing the quality and diversification of exports and to job creation.

At the aggregate level, the figures show a steeper decrease in investment in non-oil manufacturing with regard to resources manufacturing activities, while commercial services will remain quite stable. However, more disaggregated analyses, based on the number of projects announced in specific sectors, as recorded by the ANIMA-MIPO observatory, offer some signs of a positive reshuffling of sector compositions. In 2011 and 2012 in particular, there was evidence of slight progress in some new industrial sectors, such as software, the automotive industry and pharmaceuticals, and a sharp rise was observed in terms of projects announced in the two high-tech sectors of aeronautics and engineering (Noutary and Louçon, 2013).

Conclusions

Political turbulence since the early 2000s has negatively affected the level of FDI in the MENA region, as well as its composition, skewing it towards activities that create few jobs and have low spillover effects on growth, export upgrading and inclusive development.

The regional picture for 2014 is still marked by uncertainty and serious political risks at the domestic level. Oil-exporting countries' growth was more volatile in 2013 and was moreover weakened by the worsening of the political conflicts in Libya and Syria. Growth prospects for the region's oil importers were weak in 2013, only slightly better than in 2012. The slow pace of economic reforms combined with increasing economic and political instability could undermine investment and growth in the long term. The economic policies and growth strategies pursued in the past must be thoroughly revised, and the challenges of political transition and economic governance must be addressed. This can be achieved only if institutions and the investment climate are reinforced, especially with regard to political and macroeconomic stability, the legal framework, property rights and transparency rules (Gasiorek, 2013). Europe, which remains the main investor in the region, can play a key role in this process and could facilitate the transition by adopting a new more political, institutional and focused partnership (Femise, 2014).

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