

FDI in the MENA Region: Factors that Hinder or Favour Investments in the Region

Federico Carril Caccia

PhD Candidate
University of Granada

Juliette Milgram Baleix

Associate Professor
University of Granada

Jordi Paniagua

Assistant Professor
University of Valencia

A striking feature of the new globalization process is the role played by multinational enterprises (MNEs) in generating employment, growth, productivity gains, technology transfers and in opening a gateway to a better integration in global value chains (Harrison, 1994; Del Prete et al., 2018). Attracting foreign direct investment (FDI), therefore, is placed at the top of the agenda for most countries.

From the investors' perspective, political risks is, after macroeconomic instability, the factor that poses the greatest constraint on investments in developing countries (MIGA, 2014). Within political risks, adverse regulatory changes and breach of contract are the troubles that investors fear the most. This issue has been exacerbated by the Arab Spring, as it brought a surge of political instability and violence in the Middle East and North Africa (MENA) region.

This article builds on the limited research which focuses on this region and on our own study (Carril-Caccia et al., 2018). We delve further into MENA region capacity to attract FDI, highlighting the role played by institutions and violence.

The Main Characteristics of FDI in MENA

As shown in Table 8, during the period 2003-2012, greenfield investments (GI) were the mode of invest-

ment preferred by multinational enterprises (MNEs) in MENA. In most countries, greenfield investments represent over 80% of total FDI projects. These new foreign firms directly created more than 50,000 jobs in Algeria, Egypt, Morocco, Saudi Arabia, Tunisia and United Arab Emirates, contributing to the fight against high unemployment. On average, greenfield investments represent 4.86% of MENA GDP, with Kuwait, Iran and Lebanon at the bottom of the distribution and Qatar, Bahrain and Tunisia at the top.

As regards its evolution, the Great Recession and the Arab Spring have brought about a sharp decrease in FDI in the region (Map 1). This significant drop in FDI is not surprising since Western countries, the main investors in MENA, are the countries who suffered the most from the crisis, hampering their capacity to invest abroad. At that time, the Arab Spring brought a surge in political instability and violence, aspects prone to deterring FDI.

Which countries invest in MENA? As illustrated in Chart 9, Europe (especially France and the UK), the US and UAE have a prominent role in the region. Then, China, India and Japan are also relevant investors for certain oil producers. MENA non-oil producers attract investors from closer countries (the US is an exception), while oil producers are able to attract capital flows from further afield.

The Determinants of FDI: Specificities of MENA

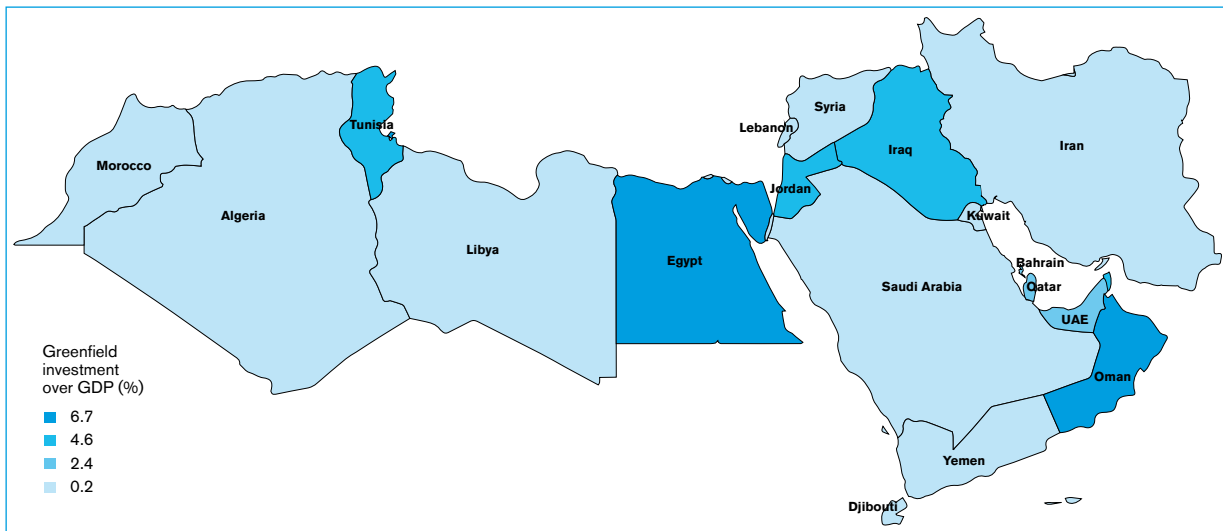
Firms' motivations to invest abroad are usually classified according to conventional FDI theory (Dunning 1993). Developed countries are natural recipients for market and strategic asset seeking FDI, which is positively related to market size and capital-labour intensity. In contrast, FDI in developing countries like MENA may respond to other motiva-

TABLE 8 Characteristics of Greenfield Projects in MENA, 2003-2012

Country	Code	Projects	Volume	Jobs	GI/GDP	GI/Total FDI
Algeria	DZA	203	32,659	58,581	3.1%	91.3%
Bahrain	BHR	228	18,033	30,899	9.7%	91.6%
Djibouti	DJI	6	1,658	2,988	6.8%	95.0%
Egypt	EGY	343	55,502	91,183	5.1%	76.3%
Iran	IRN	77	18,123	22,369	0.9%	87.1%
Iraq	IRQ	107	22,845	16,088	3.7%	89.5%
Jordan	JOR	121	8,622	23,198	5.9%	69.1%
Kuwait	KWT	64	4,242	6,251	0.5%	80.8%
Lebanon	LBN	76	3,921	12,187	1.6%	86.2%
Libya	LBY	90	32,965	21,264	7.0%	90.7%
Morocco	MAR	338	26,683	97,676	4.0%	87.0%
Oman	OMN	173	23,684	29,103	6.4%	90.3%
Qatar	QAT	297	71,780	42,920	13.1%	94.9%
Saudi Arabia	SAU	500	96,587	84,112	2.6%	89.5%
Syria	SYR	75	17,216	27,712	2.8%	92.6%
Tunisia	TUN	227	30,440	51,600	8.3%	89.2%
UAE	ARE	1,732	75,106	147,582	3.7%	92.2%
Yemen	YEM	18	4,039	2,414	2.3%	84.1%

Source: Greenfield investment data has been retrieved from the *Financial Times* service, fDi Markets. Volume is in millions US\$, and its percentage over GDP is calculated by taking the GDP from the World Bank's Development Indicators. The data from the last column refers to the percentage of greenfield investment projects over total investment projects in each country (greenfield investment and Mergers and Acquisitions/M&As). The ratio is calculated based on data retrieved from the *World Investment Report 2015* annex tables 11 and 22. UAE refers to United Arab Emirates.

MAP 1 Greenfield Investment as a Percentage of GDP (2009-2012)



Source: Greenfield investment data has been retrieved from the *Financial Times* service fDi Markets and GDP from the World Bank's Development Indicators. Averages are calculated for the period 2009-2012.

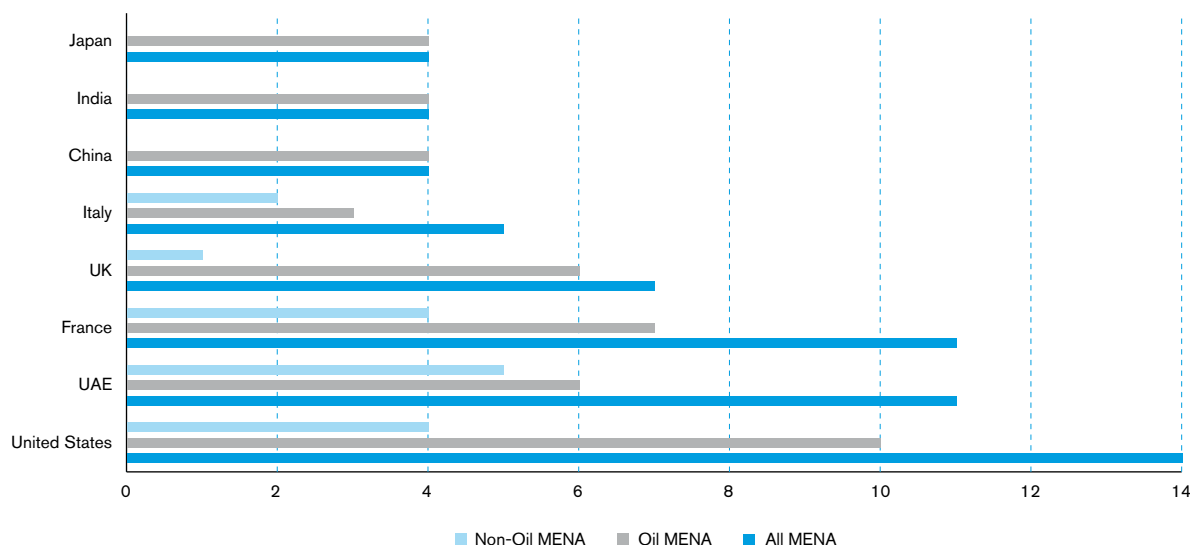
tions such as efficiency or resource seeking. The former, vertical in nature, aims to reduce costs and is therefore sensitive to trade costs, accessibility, infrastructure and labour costs (Hanson et al., 2005). Alternatively, the latter is conditioned by the availability of natural resources.

Based on bilateral greenfield investment data for 160 countries during the period 2003-2012 (retrieved from fDi Markets), this study unearths the particularities of FDI determinants in MENA. To this end, we estimate a gravity model that allows us to

disentangle the role of market size, geographic and cultural distance, historical ties, free trade agreements (FTA), bilateral investment treaty (BIT), and institutional frameworks. Moreover, we assess if the factors driving FDI are different whether the host is an oil producer or not.

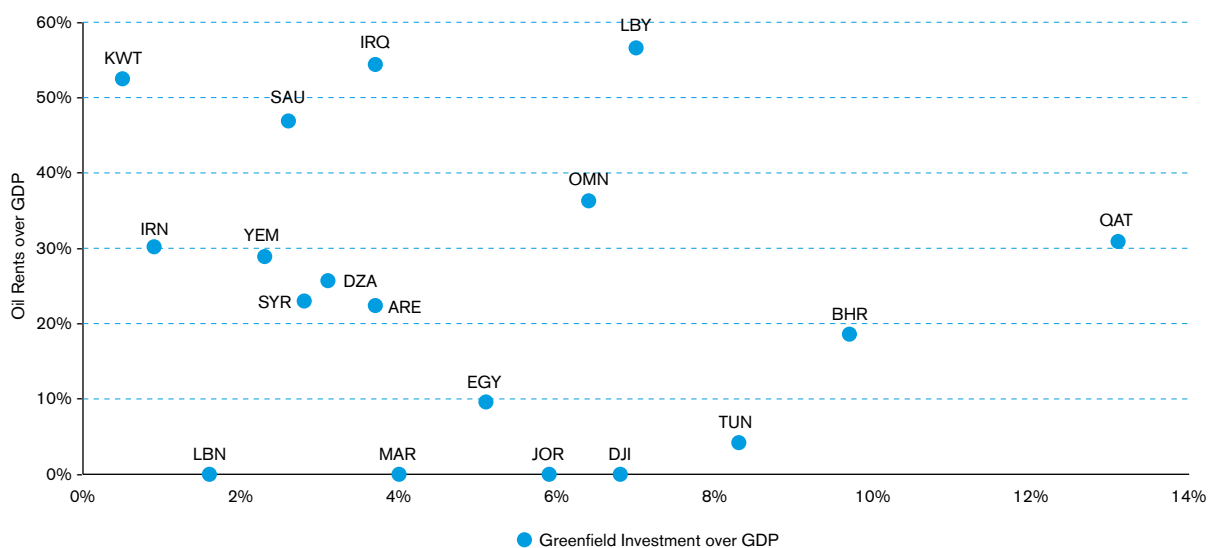
Concerning possible specificities of MENA as host countries, our results suggest that cultural ties trigger FDI in MENA: sharing the same religion and language fosters investments in these countries more than in any other region. Colonial ties are meaning-

CHART 9 Top Investors in MENA



Source: The *Financial Times* service fDi Markets. Number of times a given country is among the top five investors in any MENA country.

CHART 10 Inward Greenfield Investment and Oil Rents over GDP (2003-2012)



Source: Greenfield investment has been retrieved from the *Financial Times* service fDi Markets and GDP and oil rents over GDP from the World Bank's Development Indicators. Averages are calculated for the period 2003-2012.

ful for new projects (extensive margin). Transport costs, proxied by distance from the investors, hamper bilateral greenfield investment to a larger extent for MENA non-oil producers than for the rest of the world. However, distance is irrelevant when it comes to explaining capital flows into MENA oil producers, as previously suggested.

Another specificity of MENA countries (especially non-oil producers) is their reluctance to invest in their neighborhood. As regards trade policies, the

existence of FTAs does not significantly drag inward investments in MENA, while FTAs with non-oil producers could even repel new greenfield projects aimed at serving domestic markets. Regarding BITs, they would stimulate capital flows into non-oil producers (intensive margins).

The factors pulling investors to oil producers definitely differ from the ones attracting them to oil scarce countries. When setting up new projects in the more diversified economies within MENA,

TABLE 9

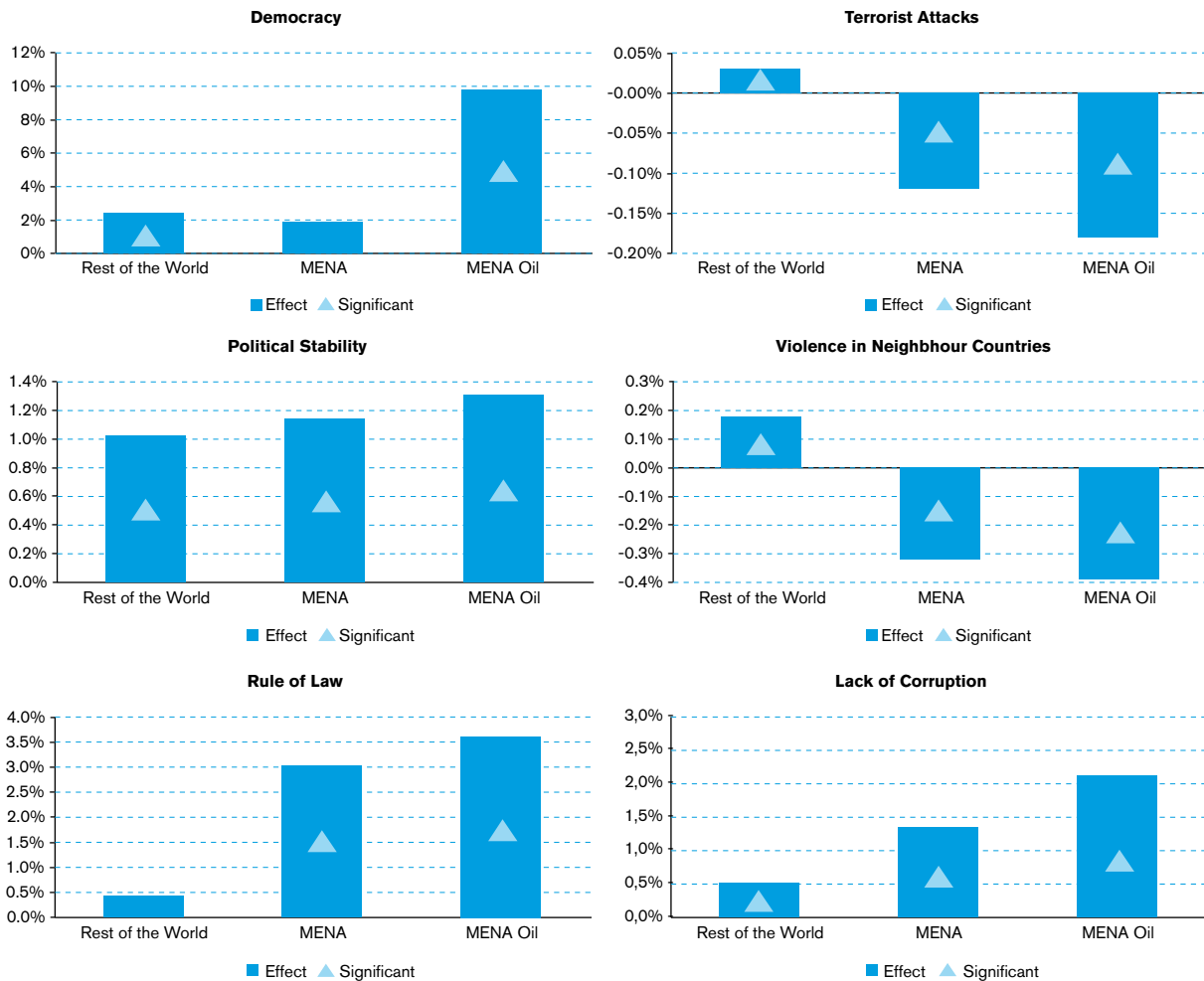
Institutions and Violence During The Period 2003-2012

	MENA oil	MENA non-oil	Other developing countries	Developed countries
Democracy	-5.78	-0.77	3.23	9.73
Rule of law	-0.23	-0.22	-0.47	1.21
Lack of corruption	-0.23	-0.27	-0.39	1.21
Political stability	-0.45	-0.47	-0.34	0.78
Terrorists attacks	7.68	0.36	0.41	0.04
Violence in neighbour countries	4.28	3.98	2.47	0.63

Source: Average for the period 2003-2012. Democracy index, number of terrorist attacks and level of violence in neighbour countries have been retrieved from Systemic Peace. The democracy index takes -10 for full autocracies and 10 for full democracies. Rule of law, lack of corruption and political stability have been retrieved from the World Bank, these indicators range from -2.5 to 2.5, going from less rule of law/more corruption/more instability to more rule of law/less corruption/more stability.

CHART 11

The Impact of Institutions and Violence on the Extensive Margin



Source: Based on estimates available in Carril-Caccia et al. (2018). The figure indicates the expected percentage change in the number of projects following a one-percent increase in a given variable (one unit variation in the case of democracy).

MNEs are particularly interested in reducing transport costs and other indirect trade costs, since their investments are more efficiency seeking. In contrast, oil producers attract lower amounts of FDI in terms of their national production (or are less dependent on foreign capitals). Countries

with an abundance of natural resources tend to attract FDI in the extractive industry while investments are crowded out in the non-resource sector. Indeed, foreign investors are not discouraged by distance, meaning that they are mainly resource seeking.

FDI, Oil and Institutions: MENA's Situation

MENA accounts for more than one third of the world's oil production.¹ Accordingly, oil rents account for large shares of the national revenues of MENA countries, except Djibouti, Jordan, Lebanon, Morocco and Tunisia. Obviously, these huge oil reserves may attract FDI but, overall, the MENA countries which attract larger amounts of greenfield investments are not the main oil producers (Chart 10). The low amounts of FDI flowing to MENA oil producers stems from different reasons: 1) Countries may exploit their resources mostly with national capital (Rogmans and Ebbers, 2013); 2) Investments may crowd out productive activities (Sachs and Warner, 2001); 3) Ill-functioning institutions repel FDI and natural resources breed corruption (Aleksynska and Havrylchuk, 2013), raise expropriation risks (Hajzler, 2014) and increase the likelihood of bad governance (Van der Ploeg, 2011). Conversely, MNEs investing in the extractive industry may prefer defective institutions (Burger et al., 2015; Poelhekke and Van der Ploeg, 2013) and stable autocracies (Asiedu and Lien, 2011). On balance, inward flows in oil may not compensate for the disinvestments in the non-resource sector (Poelhekke and Van der Ploeg, 2013).

Turning to the quality of institutions in MENA compared with other regions (Table 9), the picture is worrisome. MENA's stand out for their low level of democratization, high political instability and significant violence both domestically and in the neighbourhood. In fact, most MENA oil producers are almost full (or full) autocracies. In addition, during 2003-2012, the MENA region suffered from 69% of the world's total terrorist attacks, Iraq being the most affected country. In contrast, MENA performs better than other developing countries in terms of rule of law and lack of corruption.

What Can Be Expected in Terms of FDI from Institutional Improvement?

Institutional quality improves the prospect of weaving new bilateral relationships with foreign investors (Chart 11). Among MENA countries, oil producers

would benefit the most by reforming their institutions. This is particularly true for the political system: all else being equal, a one-point improvement in the democracy scale could boost the number of greenfield projects by almost 10%, against 2.4% for the rest of the world. For instance, if democracy in Iraq were similar to that of Lebanon, the number of greenfield projects would increase by 29%. In contrast, an equal improvement in a country like Ecuador would only lead to a growth of 7%.

Concerning possible specificities of MENA as host countries, our results suggest that cultural ties trigger FDI in MENA: sharing the same religion and language fosters investments in these countries more than in any other region

Interestingly, raising the compliance of rule of law and reducing corruption would also augment FDI in MENA oil producers to a larger extent than elsewhere. Improving each indicator by one percent could respectively increment the number of greenfield projects by 2.1% and 3.6%.

Greenfield investment in MENA is exceptionally sensitive to instability and violence. Indeed, while a one-percent improvement in political stability is expected to increase the number of greenfield investments by a similar amount, for MENA oil producers the growth would be by 1.3%. Similarly, while terrorist attacks do not seem to play a relevant role on a global level, for MENA, a 128% increase in this variable, as suffered in Iraq between 2004 and 2005, can lead to a fall in investment by 15-23%. In addition, in contrast to the rest of the world, foreign investors do not draw distinctions between the different MENA countries regarding the risk of violence and violent episodes; a surge of violence in one country prejudices the whole neighbourhood. Oil producers are characterized by especially low levels of democracy and a high degree of violence.

¹ Oil production statistics for the period 2003-2012 have been retrieved from the Thomson Reuters Eikon platform.

Improving this environment would be especially FDI-attracting. These results challenge the idea that MNEs investing in natural resources might feel more comfortable with autocracies and corruption. This may be another particularity of the region that stems from the fact that low institutional quality has limited the region's participation in the world economy (Méon and Sekkat, 2004).

Conclusions

Greenfield investments are the predominant mode of FDI in MENA and are more relevant for non-oil producing economies. After 2009, investment flows into the region experimented a negative trend, mirroring the fact that political stability is a major concern for foreign investors. Another particularity of MENA is that colonial ties, religious affinity and common language are especially influential on FDI in the region, meaning that informal barriers to invest in these countries are higher than elsewhere. Changes in the political system and improvements in the legal framework for doing business also have to be accompanied by an increase in stability and reduction in violence. This last dimension is paramount and should be tackled at the regional level. From a foreign investors' viewpoint, major violence in one of the MENAs is assimilated to regional instability, thus spreading the idea that MNEs would not be safe in the neighbourhood either.

References

ALEKSYNSKA, M., and HAVRYLCHYK, O. "FDI from the south: The role of institutional distance and natural resources." *European Journal of Political Economy*, 29, 38-53, 2013.

ASIEDU, E., and LIEN, D. "Democracy, foreign direct investment and natural resources." *Journal of International Economics*, 84(1), 99-111, 2011.

BURGER, M., IANCHOVICHINA, E., and RIJKERS, B. "Risky business: Political instability and sectoral

greenfield foreign direct investment in the Arab world." *The World Bank Economic Review*, 30(2), 306-331, 2015.

- CARRIL-CACCIA F., MILGRAM J., PANIAGUA J. et al. "FDI in MENA: Impact of political and trade liberalisation process," *FEMISE Research Papers*, FEM 41-07, 2017.
- DEL PRETE, D., GIOVANNETTI, G., and MARVASI, E. "Global value chains: New evidence for North Africa." *International Economics*, 153, 42-54, 2018.
- DUNNING, J. H. "Internationalizing Porter's diamond." *MIR: Management International Review*, 7-15, 1993.
- HAJZLER, C. "Resource-based FDI and expropriation in developing economies." *Journal of International Economics*, 92(1), 124-146, 2014.
- HANSON, G. H., MATALONI Jr, R. J., and SLAUGHTER, M. J. "Vertical production networks in multinational firms." *Review of Economics and Statistics*, 87(4), 664-678, 2005.
- HARRISON, A. "The role of multinationals in economic development: the benefits of FDI," in *The Columbia Journal of World Business*, 29(4), 6-11, 1994.
- MÉON, P. G., and SEKKAT, K. "Does the quality of institutions limit the MENA's integration in the world economy?". *The World Economy*, 27(9), 1475-1498, 2004.
- MIGA. *World Investment and Political Risk 2013*, Multilateral Investment Guarantee Agency (MIGA), World Bank, 2014.
- POELHEKKE, S., and VAN DER PLOEG, F. "Do natural resources attract non-resource FDI?" *Review of Economics and Statistics*, 95(3), 1047-1065, 2013.
- ROGMANS, T., and EBBERS, H. "The determinants of foreign direct investment in the Middle East North Africa region." *International Journal of Emerging Markets*, 8(3), 240-257, 2013.
- SACHS, J. D., and WARNER, A. M. "The curse of natural resources." *European Economic Review*, 45(4-6), 827-838, 2001.
- VAN DER PLOEG, F. "Natural resources: curse or blessing?". *Journal of Economic Literature*, 49(2), 366-420, 2011.