

HIGHLIGHTS



Middle East and North Africa Investment Policy Perspectives

Harnessing the benefits of investment for sustainable development in the Middle East and North Africa (MENA) is more imperative than ever. The health and economic crises precipitated by the Covid-19 pandemic have added to already pressing socio-economic challenges in the region. Foreign direct investment (FDI) flows have dropped significantly across the globe, and the decline in the MENA region has been particularly acute. With a significant economic contraction looming – including sharp increases to already high unemployment and poverty, and a rising risk of socio-economic instability – attracting and retaining investment will be key to supporting an inclusive recovery.

While MENA governments have begun ambitious efforts to improve the investment climate and respond to the pandemic, bolder reforms are needed to make investment work for sustainable development. This includes addressing longstanding structural challenges through ambitious reforms of the private sector, improving implementation of policies, and adopting new investment strategies to exploit emerging opportunities.

Middle East and North Africa Investment Policy Perspectives (MENA IPP) offers reform proposals to address investment policy challenges in the region, placing strong emphasis on how policy makers can leverage investment to advance sustainable development. It takes stock of investment policy trends and reforms in Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, the Palestinian Authority and Tunisia. The report encourages MENA governments to consider reforms with four overarching objectives in mind:

- Improve the clarity, consistency and transparency of investment rules and procedures
- Advance reforms to boost competition and private sector development
- Target investment policy and promotion to better serve sustainable development goals
- Strengthen good governance and co-ordination to deliver better investment policy

Improve the investment climate and realise the benefits of FDI: four priorities

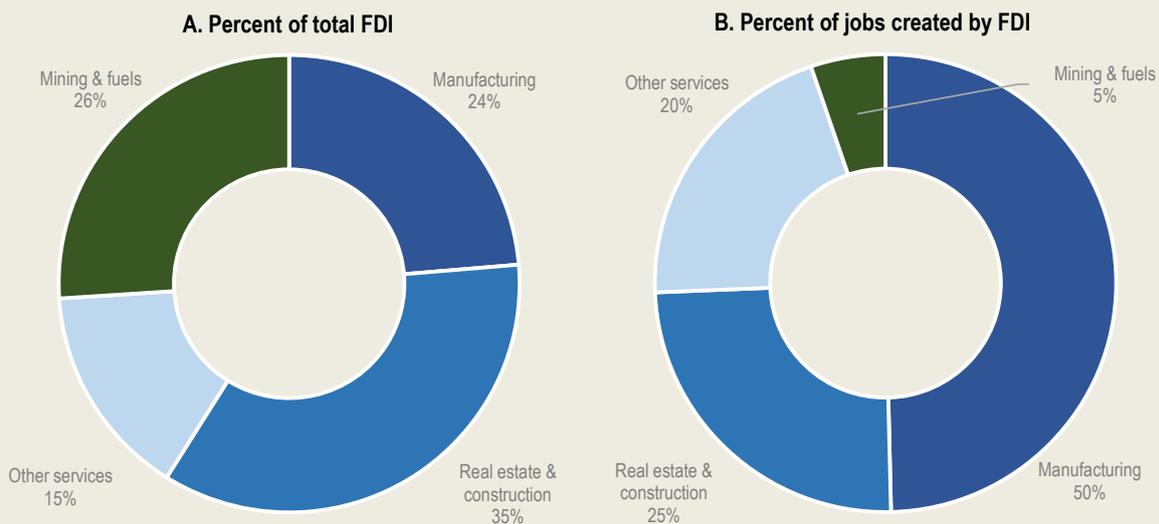
Recognising the positive role investment can play in supporting development goals – from economic diversification to creating quality jobs – MENA governments have advanced meaningful reforms in the past decade to promote and facilitate FDI. Governments have revised investment legislation, eased market entry, streamlined regulations on business operations, strengthened investment promotion agencies (IPA), and adopted policies to direct investment to under-performing regions. While some economies have attracted sizable FDI inflows, MENA governments have been less successful than other emerging and developing economies at leveraging investment to advance sustainable development. Political instability, conflict, and social and economic shocks over the past decade have all negatively affected the investment climate. The benefits of FDI have also been hindered by structural challenges shared by the diverse economies, including barriers to competition, skills shortages, inadequate infrastructure, governance challenges, and weak regional integration.

Several more immediate challenges persist for investors. Investment-related regulations are not always clear or transparent, and many rules are enforced in an overly-discretionary or ad hoc manner. Co-ordination among government agencies promoting and facilitating investment is often insufficient, limiting effectiveness of strategy implementation and its impact on improving the business climate. MENA economies rank poorly on many measures related to business integrity and responsible business conduct. More targeted investment policies, including on tax incentives and linkages between SMEs and foreign firms, could better serve sustainable development objectives and countries' engagement in global value chains (GVCs).

A common challenge: making investment work for sustainable development

In much of the MENA region, FDI has been concentrated in a few capital-intensive sectors, including extractive industries, real estate and construction, as well as light manufacturing. Many of these sectors have not sufficiently advanced job creation or economic diversification, nor have they supported the growth of small and medium enterprises (SMEs), or economic activity outside of coastal and urban regions (Figure 1). The region is nonetheless diverse. Manufacturing and service sectors have attracted a growing proportion of investment in some countries, with positive implications for exports, jobs and skills development. Despite this, in most MENA economies there is a popular perception that investment has not benefited the average citizen. OECD analysis found that across the region, the benefits of FDI for productivity, labour market outcomes and the environment do not always materialise, and not as much as host governments expect. Despite notable reforms, many areas of the investment climate continue to pose challenges to investors and private sector growth more broadly, limiting the benefits of investment.

Figure 1. FDI is not concentrated in sectors with greatest job-creating potential



Note: Based on total (announced) Greenfield FDI in the eight countries between 2003 and 2019.

Source: OECD based on fDi Markets by the FT.

Priority 1. Improve the clarity, consistency and transparency of investment rules

MENA governments have undertaken sustained efforts to improve legislation governing the investment climate. But in some cases, the fast-paced rhythm of recent reforms may have created legal overlaps and loopholes. This can have a deterrent effect on investors, particularly in jurisdictions where non-commercial risks are higher than the average. MENA governments should avoid short-term fixes and ensure that no unnecessary layers of regulation are created when endeavouring to modernise legislative frameworks. International investment treaty (IIA) policy should also be consistent with the overall legislative framework.

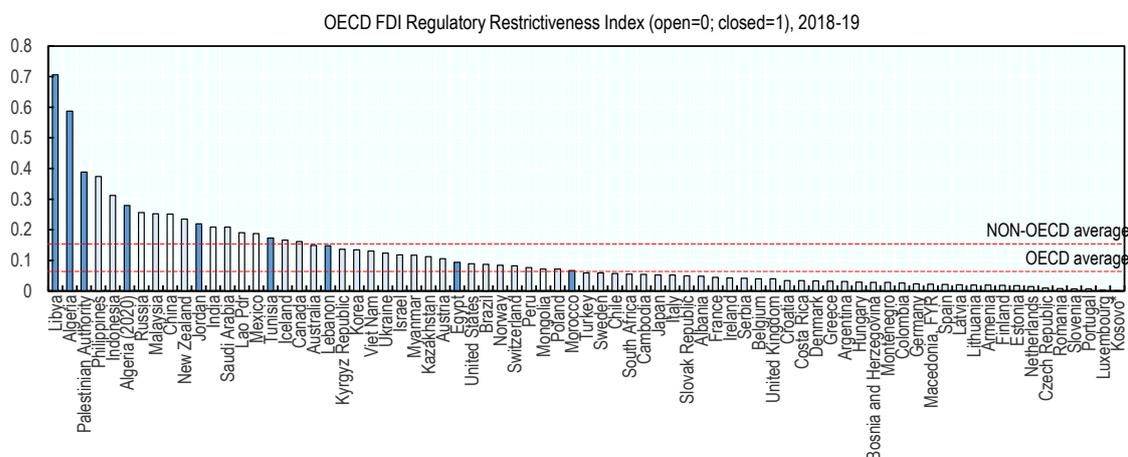
Ensuring coherence and clarity across various investment-related laws is essential for an attractive investment climate, and reduces opportunities for inconsistent implementation or excessive bureaucratic discretion. In most MENA economies, investment authorities have wide discretion to determine incentives, and in some cases, to decide which investors can enter the market and receive permits and land. Greater specificity in laws and regulations, which reduces scope for interpretation, would help curb corruption, unfair competition risks, and potential investor-state disputes.

Priority 2. Advance reforms to improve competition and private sector development

On average, MENA economies impose more restrictions on foreign investors' entry and operations, particularly in service sectors, than peer countries (Figure 2). Limiting FDI in key services, such as transport and distribution, hinders competition and productivity in these sectors and the industries that rely on them, including manufacturing, in turn holding back potential productivity gains throughout the economy. Loosening restrictions in infrastructure sectors could help improve the low quality of services in the region, reducing delays and the cost of trade. FDI restrictions in services also limit participation in global value chains (GVC). Gains from GVCs in MENA economies have been relatively limited in terms of knowledge and technology transfers to local firms, as well as engagement in higher value-added activities.

More broadly, while several MENA governments have removed important *de jure* restrictions on market entry, other barriers to competition are often prevalent. These include institutional or informal barriers to investment (such as excessive bureaucracy or corruption), inconsistent enforcement of statutory rules, as well as distortions caused by state ownership of key sectors, and special treatment received by certain firms.

Figure 2. OECD FDI Regulatory Restrictiveness Index (MENA 2019)



Note: The OECD FDI Regulatory Restrictiveness Index only covers statutory measures discriminating against foreign investors. The implementation of regulations, restrictions related to national security, state monopolies, preferential treatment for export-oriented investors and special economic zone regimes are not considered. Data reflect regulatory restrictions as of December 2019 for the MENA8 countries and 2018 for all others.

Source: OECD FDI Regulatory Restrictiveness Index (database), www.oecd.org/investment/fdiindex.htm.

Priority 3. Target investment policy to better serve sustainable development goals

MENA governments may have to re-think investment promotion strategies, both to respond to challenges, including investor caution, and harness opportunities arising from a possible reorganisation of GVCs. Digitalisation of procedures should be expanded, along with a renewed focus on aftercare and retention. Strategies should be developed through wide consultations and should focus on clear targets. Policies to attract investment with a high development impact should include more targeted, cost-based incentives in line with government priorities, to foster spill-overs such as skills development, innovation, and linkages to local SMEs. In fragile contexts, governments could target investors that are more familiar with fragility and with local economic conditions, particularly those with a good track record performing due diligence, and prioritise sectors that support post-conflict or disaster rebuilding efforts.

In supporting investment that can best advance sustainable development, MENA governments could also do more to promote and enable responsible business conduct (RBC). This includes advancing human and labour rights, gender equality and environmental protection in business activities and their supply chains. As trading partners begin to integrate RBC principles and standards in legislation, companies that participate in global supply chains must be aware of international expectations of RBC.

Priority 4. Strengthen good governance to deliver better investment policy

MENA governments have undertaken numerous reforms of their institutional framework for investment, boosting the roles of Investment Promotion Agencies (IPAs) with a breadth of mandates, including regulatory and supervisory roles often overseen by ministries in other countries. This can create confusion of roles and affect IPAs' credibility to voice private investors' concerns while they also regulate their operations. Governments should clarify responsibilities and strengthen co-ordination over investment policy, promotion and facilitation – as well as dispute management and prevention – to reduce institutional overlaps and conflicting objectives.

Moreover, aligning investment with other policies that influence the investment climate, including trade, competition, innovation, infrastructure connectivity, and anti-corruption, would promote policy coherence. Better sharing responsibilities between national and subnational bodies could also improve policy delivery. When developing policies, MENA governments could further solicit investors' and other stakeholders' views; facilitating an environment of trust between the government and business community is especially important in uncertain times. To ensure accountability, governments should set up proper monitoring and evaluation mechanisms of planned reforms to improve transparency.



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