**MENA-OECD Government-Business Summit**

30-31 March 2021

## Session 1: Promoting a sound business climate and attracting investment

Investment, both foreign and domestic, is crucial for economic growth and sustainable development, contributing to private sector development and overall economic and social well-being. Under the right conditions, foreign direct investment (FDI) can foster technology spillovers, human capital formation, international trade integration, help create a more competitive business environment, and enhance enterprise development (OECD, 2015). It can also play an important role in accelerating economic diversification and stimulating small and medium-sized enterprises (SMEs) through business linkages.

Investment policy reforms have been a high priority for the MENA region over the past decades. While some MENA economies have been fairly successful at attracting foreign business, FDI in much of the region remains below its potential compared to other developing and emerging economies. This is not only due to periods of instability and conflicts in some MENA economies, but also the structural challenges shared by many of the diverse economies of the region, which are hindering the growth of a dynamic, competitive and rules-based private sector (OECD, 2021 forthcoming). These include insufficient competition, skills shortages, inadequate infrastructure, political instability, governance challenges, and weak regional integration.

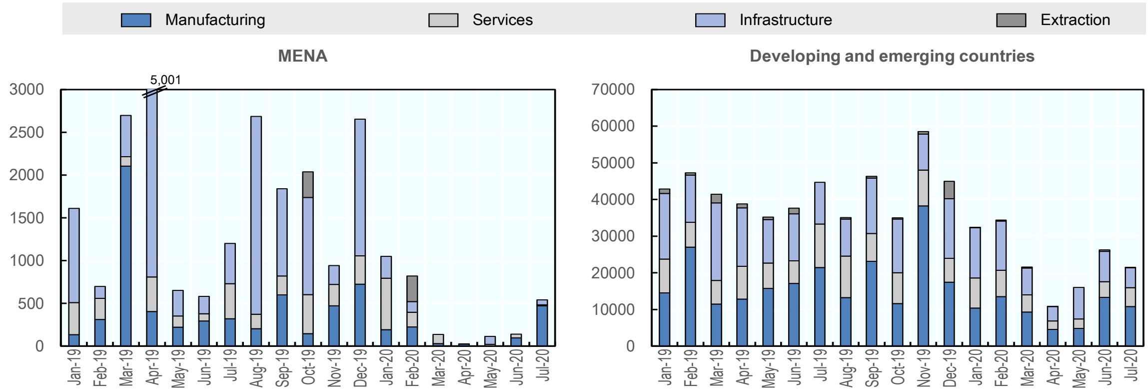
The global economic crisis created by the Covid-19 pandemic is likely to increase poverty, unemployment and macro-economic instability across the region (UN, 2020). This new reality makes it even more imperative to commit to effective reforms to ensure that investment contributes positively to sustainable development. Leveraging investment to support the economic recovery will require policymakers to adopt targeted strategies, as well as to address persistent challenges to competitive markets and advance policies to support more inclusive growth.

### *The Covid-19 crisis has negatively affected foreign direct investment in the MENA region*

Investment levels in MENA have declined sharply in 2020 due to the Covid-19 pandemic and resulting economic and social shocks. The pandemic contributed to global FDI plunging 50% in the first half of 2020 compared to the second half of 2019, the lowest half-year level since 2013 (OECD, 2020a). This negative trend was also registered in several MENA economies. In eight economies, in the region, the total value of greenfield investments in the first half of 2020 was 80% less than in the same period in 2019 **(Figure 1)**. By comparison, greenfield investment in emerging and developing economies overall dropped by 42%. The reduction of greenfield investment affected sectors crucial to MENA economies, including tourism, energy and manufacturing. In some cases, however, the slowdown in investment in the region resulted in projects being put on hold, rather than divestments or cancellations of projects (OECD, 2020b).

MENA governments rolled out numerous measures to respond to the health, economic and social impacts of the crisis. These include fiscal packages to support hard-hit sectors and SMEs, including through cash and in-kind transfers, deferred tax and loan payments, and reduced utility bills. To respond to investors’ concerns, most Investment Promotion Agencies (IPAs) in the region have refocused on aftercare services to support and retain existing investors. Governments are also considering revising incentives to attract investment in sectors vulnerable to supply chain disruptions, including agriculture.

**Figure 0. Greenfield FDI in selected MENA and developing and emerging economies (Jan-July 2020)**




Note: Announced capital expenditure, USD millions. Data for MENA covers the following eight economies: Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, Tunisia and the Palestinian Authority. Data for Developing and emerging countries covers 153 countries from the International Monetary Fund Balance of Payments Database (https://data.imf.org/BOP)
Source: OECD based on Financial Times FDI Markets, as of 10 September 2020.

These short-term measures have been crucial to respond to the immediate effects of the pandemic. However, in the medium- to long-term, many MENA governments may have to re-think investment strategies, both to respond to new challenges of attracting investment and to harness potential opportunities. MENA economies could attract new multinational firms considering diversifying or shortening their supply chains.

## *The way forward: What policies to harness investment and improve the business environment will be key to the post-pandemic recovery?*

- ***Clarifying and streamlining the regulatory framework for investment can improve the business environment.*** While several MENA countries have streamlined regulations for investors, or eased procedures by centralising administrative steps in one-stop shops, the regulatory framework for investment is often not predictable or transparent. Ensuring coherence and clarity across various investment-related laws is essential for an attractive investment climate, and reduces opportunities for inconsistent implementation or bureaucratic discretion. In many MENA economies the criteria to receive tax benefits, and in some cases, which investors can enter the market, receive licences, permits and land, is not always clear and transparent (OECD, 2021 forthcoming).

- ***Further liberalisation reforms can promote private sector development.*** A critical component of the wider legislative framework for investment are the rules governing market entry and operations. According to the 2019 OECD FDI Regulatory Restrictiveness Index, covering statutory FDI restrictions (those explicit in regulations or laws), Egypt and Morocco impose restrictions similar to OECD countries, while Libya, the Palestinian Authority and Algeria are significantly more restrictive compared to OECD and non-OECD peers. Jordan, Lebanon and Tunisia impose restrictions close to the average non-OECD economy. Sector-specific limits on foreign equity ownership are the most prevalent forms of discrimination against foreign investors (OECD, 2021 forthcoming).

- ***Improving the governance of state-owned enterprises could strengthen competition.*** State-owned enterprises (SOEs) continue to play a fundamental role in MENA economies, and are dominant in many sectors. State ownership gives rise to unique governance and regulatory risks that can prevent SOEs from creating optimal value for the economy and society. Many MENA SOEs benefit from special regulatory treatment, from preference in public procurement to exemption from certain laws. MENA governments could further promote competition and address the externalities associated with the prevalence of few dominant enterprises, one of the main impediments to more dynamic job and enterprise growth in the region.

- ***Targeted policies and programmes could enhance SME-MNE linkages in GVCs.*** Leveraging FDI to integrate SMEs in global production networks can be an opportunity for the MENA region to achieve more inclusive and sustainable growth, especially in the post-Covid-19 recovery. Foreign manufacturers in MENA countries, including in Egypt and Morocco, are a key source of revenue for domestic suppliers. However, business relationships are often limited to the sourcing of low-skilled inputs, rather than contractual arrangements for R&D or other upstream activities. MENA governments could opt for targeted policy actions to enhance SME-MNE linkages, including through access to finance, specific incentives for supplier development programmes, such as those helping SMEs to form consortia (e.g. to respond to large orders from clients), improving quality, and strengthening managerial and technical skills.

- ***Dialogue with the private sector on future investment reforms could enhance policy legitimacy.*** While some government-private sector consultations on investment reforms and strategies are already taking place, MENA economies could benefit from deepening and institutionalising their scope. These consultations also instigate an environment of trust between the government and the business community, particularly important during uncertain times. To avoid regulatory capture by a small group of large and influential companies, private sector participation in such consultation mechanisms should be based on transparent selection criteria.

***Key questions for Discussion:***

• What are the challenges, opportunities and policy options for investment recovery in the MENA region?

• How does the private sector assess the government crisis response with regard to sustaining and retaining investment?

• How the economies in the MENA region can build the ground for important reforms such as SOEs or further removing investment restrictions?

• What type of quality investments are needed to enable SME development and job creation?

• What are the policy priorities to advance trade and investment integration in the region?

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### *Further Reading*


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