Challenges of the Foreign Direct Investments in the Maghreb

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Summary:

The following article applies the propositions put forward in the framework to the case countries. In order to understand the dynamics and current challenges of the Maghreb countries, a case approach is employed. Thus, this section starts with a presentation of the current political agenda surrounding and influencing Maghreb countries. Subsequently, motivations for trade and potential integration are examined while trends of nation-wide policy formulations are compared.

Later on, a narrow investigation of factor endowments and trade patterns of important industries of Maghreb depict locational settings while keeping key investors in mind. Concluding, those factors are tested against my suggestions in a comparative analysis, before a detailed positioning of Maghreb counties, as regarded via the Investment Development Path, takes place. This will eventually answer the research question about delicate Maghreb FDI patterns.

Introduction:

Even though world Foreign Direct Investment (FDI) flows have been growing rapidly, FDI is still decisive - especially for developing economies. As indicated by UNCTAD (2004) international production is now accomplished by over 900,000 foreign affiliates of at least 61,000 Transnational Corporations (TNCs) worldwide and more and more players are integrating in the worlds economies. These foreign affiliates make up about one-third of the world exports and one-tenth of world GDP. Recently, outward FDI from developing countries is becoming significant as FDI outflows from developing countries have grown faster than those from developed ones. Outward FDI now accounts to more than 10% of world total stock. Moreover, south to south (i.e. developing countries to developing countries) FDI flows have grown faster than those from south to north (i.e. developing countries to developed countries).

However, compared to other developing regions, Foreign Direct Investments (FDI) is lacking behind in the Maghreb region. Investment flows reach other regions but almost neglect Maghreb. Since the Barcelona Process Declaration in 1995 and the proclaimed advancement to reach a Euro Mediterranean Free Trade Area (EMFTA) in 2010, progress has been slow and not as anticipated. In other words, the economic performance of Maghreb countries falls short in terms of amount and diversification of trade and FDI In- and Outflows. This article is a contribution to this on-going debate in the Maghreb among key decision makers and business representatives. An important element of such debate is a clear understanding of the implications and benefits of further integration with regional, European and global markets and resulting FDI inflows and outflows. The Middle Eastern and North African (MENA) region in general, but also Maghreb countries as such (namely Algeria, Morocco and Tunisia) , includes various countries with different economic structures and resources, however these countries have some general common characteristics such as heavy reliance on gas and oil, a weak economic base, high population growth and unemployment rates. Also a dominance of the state in the economic sector, low level of integration with the world, underdeveloped financial and capital markets, underdeveloped institutions, and low rates of returns on human and physical capital are frequently mentioned.

Most importantly, MENA countries share similar features as long as FDI related figures are concerned. Therefore, the Investment Development Path (IDP) framework brought in by Dunning (1981) can be a useful tool for investigating the net FDI position of the MENA region in relation to its development, particularly focusing on Maghreb countries.[1]

[1] Philipe Siegle, explaining FDI Performance of Maghreb Countries, Copenhagen Business School, 2008

Analyis and understanding of the dynamics and challenges of the FDI in the Maghreb:

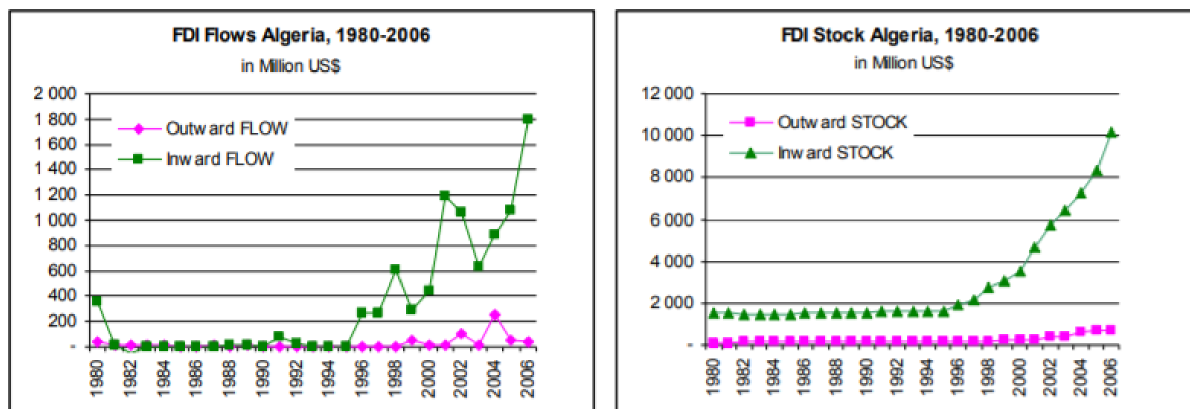
In order to understand the dynamics and current challenges of the Maghreb countries, a macro perspective is discussed. Thus, this section starts with a presentation of the current political agenda surrounding and influencing Maghreb countries. Subsequently, motivations for trade and potential integration are examined while trends of nation-wide policy formulations are compared. Later on, a narrow investigation of factor endowments and trade patterns of important industries of Maghreb depict locational settings while keeping key investors in mind. Concluding, those factors will be tested against the suggestions in a comparative analysis, before a detailed positioning of Maghreb counties, as regarded via the Investment Development Path, takes place. This will eventually answer the research question about delicate Maghreb FDI patterns.

Case Presentation:

In this section, the three Maghreb countries are portrayed in terms of political systems and recent trade and investment policies to eventually exhibit similarities and differences in their FDI flows, stock and gross fixed capital formation (GFCF). As outflows in particular are minimal, a 29 percentage of GFCF is not included. Algeria, Morocco and Tunisia are compared to other parts of the world and in contrast to the developing countries and developed countries to complementarily position them.

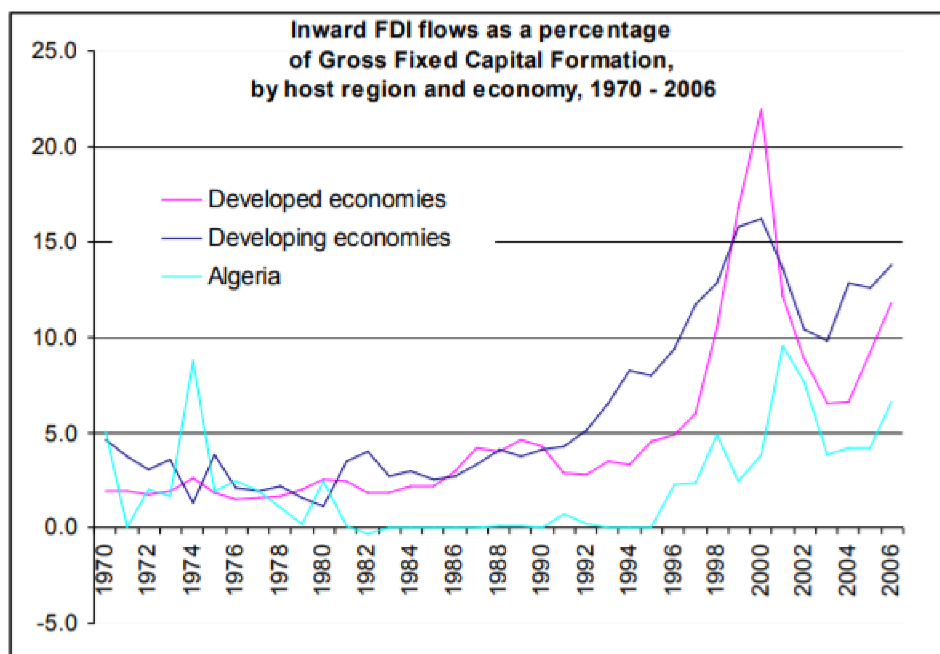
Algeria's policies According to UN estimates, "The People's Democratic Republic of Algeria" has a population of 33.9 million (UN, 2007). President Abdelaziz Bouteflika secured a landslide election victory in April 199 and is still governing. He promised to seek "true national reconciliation" during his now second term (BBC). Among the areas open to foreign investors in Algeria are the huge reserves of natural gas and other hydrocarbons. The country is the largest supplier of natural gas to the European Union (EU). It projects to increase oil and gas revenue over the coming decade and so the government is eager to attract substantial foreign investment to the sector. The Government of Algeria announced in 2002 that it would privatize, either fully or partially, 100 state-owned firms. However, in 2005, Algeria altered its strategy towards investment in the oil and gas sector to increase the share of Sonatrach, the state-owned oil and gas company, in all exploration and production contracts awarded to foreign investors. Algeria is a member of the Arab Maghreb Union, New Partnership for Africa's Development and the African Union. In 2001, the country signed the Trade and Investment Framework Agreement (TIFA) with the United States, effectively establishing the common principles on which the economic relationship is founded. Algeria also initiated an accord as part of the European Union's drive to build stronger relations with neighbours in the southern and eastern Mediterranean. Central to the agreement is a dismantling of trade barriers over 12 years. It is expected that these will lead the country to implement more reforms, especially in the banking and finance industries and ultimately boost FDI inflows into Algeria.

Figure 1 & 2:



Coming from nearly zero, FDI inflows to Algeria augmented steadily to reach its current peak at $1.8billion. After a global boom, 2002 marked the second highest level since 1990, even with a decline of 11%. The high levels of inflows were explained by an increase in oil and gas explorations, bolstered by economic reforms that are taking place in the country. FDI outflows also witnessed growth between 2001 and 2002 (Figure 6). Inward FDI stock multiplied fourfold between 1995 and 2002 and almost doubled between 2002 and 2006. They increased from about $1.5 billion in 1995 to nearly $6 billion in 2002 to more than $10 billion in 2006. (Figure 2)

Figure 3

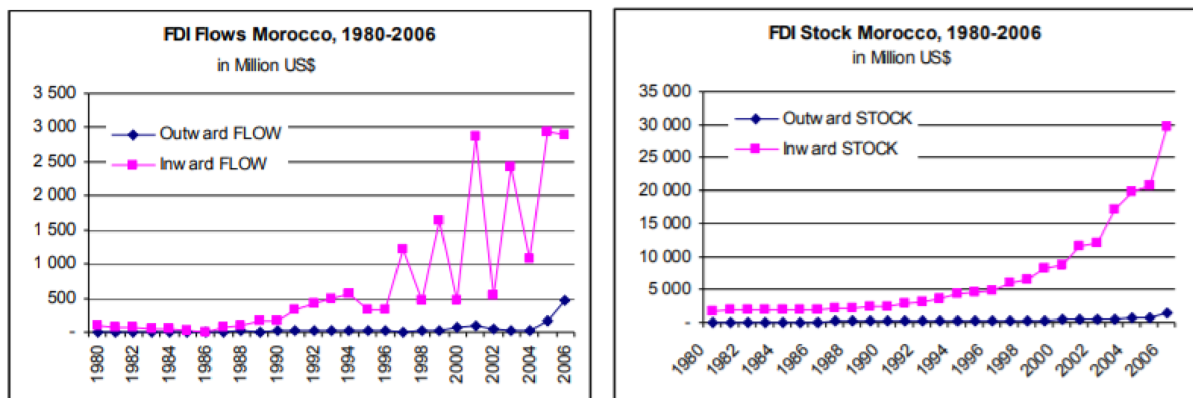


FDI inflows as a percentage of gross fixed capital formation grew from around 0% in the 90s to about 4% in 2000 to over 8% in 2001 before levelling out around 5%. (Figure XX).

Morocco's case Although the fourth largest country in the region, Morocco has a rather small but open economy, its degree of openness is now close to 70% of GDP. Morocco has recently experienced an improvement of its average GDP growth to some 5.5% (from 3.2% in 2002). The country recorded another current account surplus in 2003, with stronger investment activity and sustained private consumption.
With a population close to 30 million, Morocco's "constitutional, democratic and social monarchy", led by King Mohammed VI, controls and economy amounting to $37,263 million (GDP 2002)15. It is highly dependent on agricultural production, which accounts for roughly 14% of GDP but involves more than 50% of the labour force. The dependency on agricultural output and erratic meteorological conditions has traditionally led to a high volatility in the growth rate. The slow growth rates in the 1990's translated into a stagnant per capita income level of €3.690 (PPP) in 2002. The economy has not been able to alleviate pressures stemming from the rapidly increasing labour force (population growth, although declining, is still 1.7 %). Unemployment levels remain high (over 20% in urban areas).
Following an economic crisis in 1983, the government substantially reduced trade protection, cut the fiscal deficit, and rescheduled its external debt. While the 1990s have been characterised by a high degree of macroeconomic stability, a slippage in fiscal discipline has been noted recently. With regard to economic growth Morocco's performance has been disappointing over the last decade, declining to an average 2.3% per year compared to an average of 4% in the 1980s. Lower growth rates were mainly due to external developments (six droughts in ten years, slow European growth) as well as stagnating overall structural reforms. Progress in recent years includes, among others, the modernisation of the customs administration, the privatisation of public enterprises, telecommunications reform, and trade liberalisation in accordance with the Association Agreement with the EU. Since 2001, the growth rate has improved, rising to 5.5% in 2003. This improvement reflected the 20.6% increase of agricultural output16 .
Morocco has a wide scope for FDI because of its abundant natural resources. It is the world's largest exporter of phosphates - both raw phosphates and processed products, including phosphoric acid and fertilizers17. Other minerals including silver, zinc, copper and Cobalt are also extracted. Manufacturing is dominated by the clothing and textiles industry while there are small but growing electrical and mechanical industries
Morocco has continued to make its economy attractive to foreign investors by reforming investment laws, liberalizing trade and prices, reducing red tape, updating the financial system, privatizing some state firms and offering concessions in telecommunications, power generation and water management.
Under the privatization and liberalization programme, the telecommunications sector has been opened to competition and is expanding rapidly with new services and new platforms. The state telecommunications regulator, Agence nationale de régulation des télécommunications (ANRT), has overseen the liberalization of the sector.
Morocco is increasingly integrated into the regional and international economic systems through its membership in the regional integration schemes such as the Arab

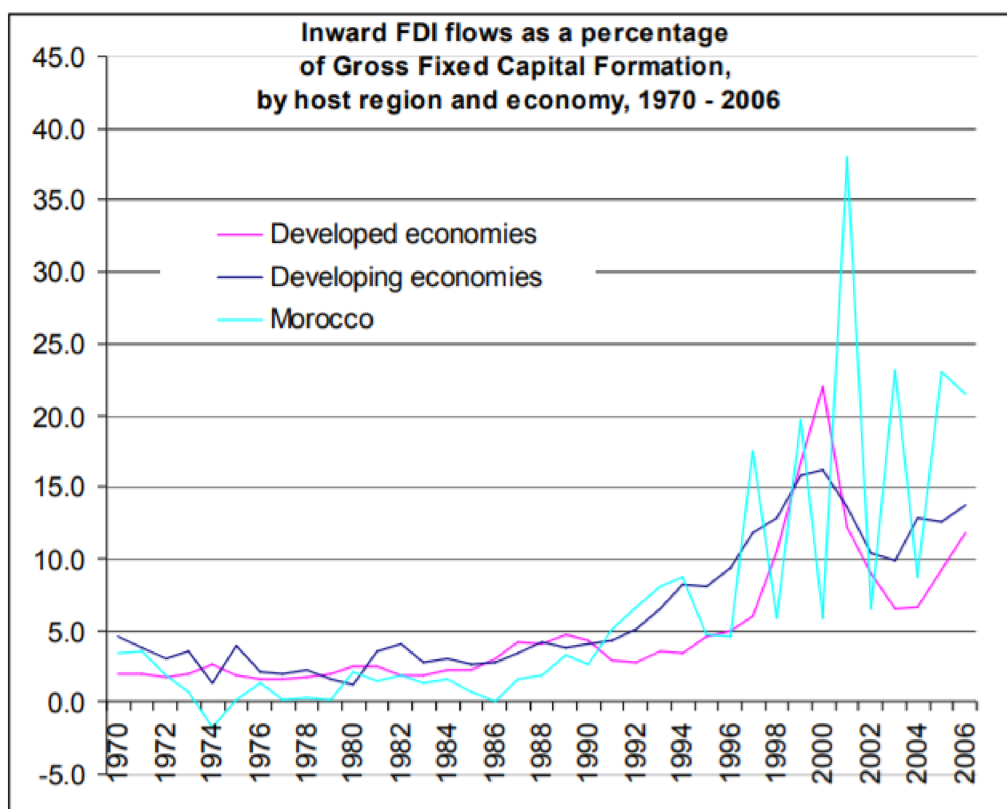
Maghreb Union, and the Association Accord with the European Union. However, aside from privatisation, UNCTAD proclaims that the overall FDI flows have remained at a rather low level. Measures have been taken to reinforce the legal environment for investors and to improve so-called "welcoming services" for foreigners. In January 2002, a new decentralised investment service was launched and regional investment centres are being opened, although they still lack resources to function efficiently. The main obstacles for foreign investment relate to i.e. complicated procedures for business registration and a lack of transparency in the regulatory framework. Another aspect are rainfall levels, which can influence the annual growth rate. It is said to have a high degree of volatility, in line with rainfall levels, which continue to determine the economic situation. Other estimates suggest that Morocco's growth potential is limited, due to its over-reliance on the agricultural sector, limited internal market and low total factor productivity19

Figure 4 and 5:



Growth in FDI inflows to Morocco has widely fluctuated since 1996, and in 2002 it took a nose dive, from $2.9 billion in 2001 to $533 million in 2002. The downturn in 2002 was a return to the normal level after an exceptionally large acquisition that took place in the telecommunications sector in 2001. However, the graph portraits the bouncing back and recent ups and down with a current levelling out at around $3 billion. FDI outflows followed a similar pattern, declining from $97 million in 2001 to $29 million in 2002 before climbing up to $500 in 2006 (Figure 4). Inward FDI stock surged from less than $1 billion in 1990 to almost $10 billion in 2002. Outward FDI stock reached its highest point, at a little above $0.8 billion in 2002 (Figure 5).

Figure 6



FDI inflows as a percentage of gross fixed capital formation (GFCF) declined from 38% in 2001 to 6% in 2002. Since 1996 this yearly up and down is visible, where jumps from around 7% to around 20% are common. In 2005 and 2006, however, a rather high level of above 20% was reached.

Tunisia's situation With about 10 million inhabitants, Tunisia followed a period of high growth rates (5.2% on average for the period 1997-2001). However a combination of negative domestic and external shocks led to a modest GDP expansion of 1.7% in 2002. An export-led recovery followed in 2003, driven also by increased agricultural production. GDP grew 5.6% in 2003. Export revenues increased by 34 around 12% in the first eight months. The Iraq crisis and the Casablanca terrorist attack had an impact on the tourism industry in early 2003, although relatively moderate (tourism fell by 9%).

Thanks to prudent macroeconomic management, Tunisia is experiencing a relatively high degree of price stability with inflation levels well below 5% since the second half of the 1990's. Tunisia is a constitutional presidential republic. The President of the Republic is the Head of the Executive. He is elected by universal suffrage. The ex President, Zine El Abidine Ben Ali, has been in power since 1987 and in the last elections in 1999 received 99.4% of the votes.21 The Government has been particularly keen to encourage foreign investors to invest in manufacturing plants in Tunisia to serve the European market by offering attractive investment incentives to export-oriented investments. For example, exporting companies can import all necessary capital goods and production inputs custom duty free. They are also fully exempt from income tax for the first ten years of activity followed by a 50% reduction in income tax thereafter. Foreign investors can hold up to 100% of the project capital

without prior authorization, except for exporting service industries which are subject to authorization if the foreign participation exceeds 50% of the capital.

From 1995, privatization was sped up and by 2005 the government had disposed of large businesses. About 160 public enterprises had been fully or partially privatized or been shut down and their assets sold off. Foreign investors also benefit from the off-shore status of wholly exporting companies: whether in the form of off-shore factories which can be set up anywhere in Tunisia, or within a free zone. Two free trade zones are set up in Tunisia, one in Bizerta and the other in Zarzis. The incentives offered by these free trade zones strengthen the interest already shown by foreign investors in Tunisia.

Oil has played a large role in attracting FDI to Tunisia and exploration remains buoyant. The law concerning exploration activities was revised in early 2000 to give the government greater flexibility in fixing terms with operators, taking into account exploration costs, field size and changing world oil and gas prices. This cleared the way for an expansion of petroleum activities. Approximately 43 exploration permits were in operation in 2002. The British Gas investment in the Miskar gasfield in the early 1990s is still Tunisia's largest single foreign investment.

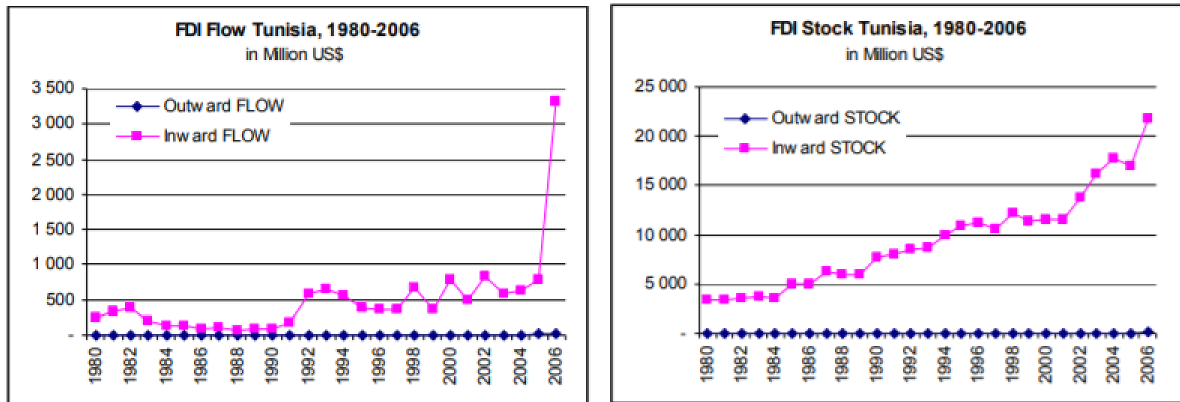
Non-energy foreign investment did not rise much until 1998, despite many initiatives to encourage it. However, since 1998, the main focus of FDI has been on manufacturing. After the cement sector, the textiles industry has attracted the most foreign investment, followed by shoes and leather, vehicle parts, electronics, pharmaceuticals, food, and computer software. The tourism sector is also growing in importance. The main investors are from European companies – mainly France, the United Kingdom, Germany and Italy, and the United States.

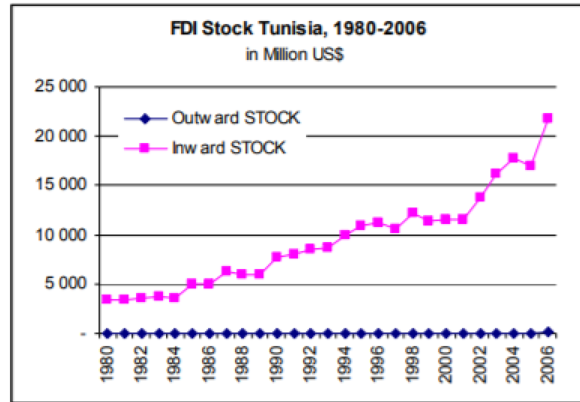
Tunisia has good infrastructure, a reasonably well-trained and adaptable workforce, enjoys proximity to Europe and is improving its integration into the world economy. The country is provided free access for industrial goods to European markets through its Association Agreement with the European Union (EU), and reduced customs duties for exports to the United States, Canada, Switzerland, Australia and Japan. It is the first country of the southern shore of the Mediterranean to have signed an association agreement with the EU. This agreement, signed on 17 July 1995, extends cooperation to culture, education, economy, scientific research and political and social dialogue. It provides for the gradual establishment, over a period of 12 years, of a freetrade zone for industrial products (EMFTA). Another agreement on agricultural trade with the EU came into force on 1 January 2001. The agreement raised Tunisia’s annual quota for duty-free exports to the EU and fixed other quotas for other agricultural items. In return, Tunisia agreed to remove import duties on European wheat and vegetable oil imports over five years22 .

Tunisia also signed free-trade agreements with Egypt, Morocco, Jordan and Libyan Arab Jamahiriya. In 2001, Tunisia signed a declaration with Egypt, Morocco and Jordan calling for a free-trade zone among the Arab states of the Mediterranean, which is to become a precursor to the proposed Arab free-trade area. At the end of 2005, Tunisia belonged to major integration schemes such as the Arab Maghreb Union, African Union, New Partnership for Africa's Development and World Trade

Organization. Tunisia also supports the "Eizenstat plan" to develop trade links between the United States and Tunisia, Morocco, Algeria and Egypt. Out of all pending initiatives however, only the EU partnership has so far become a reality23 .

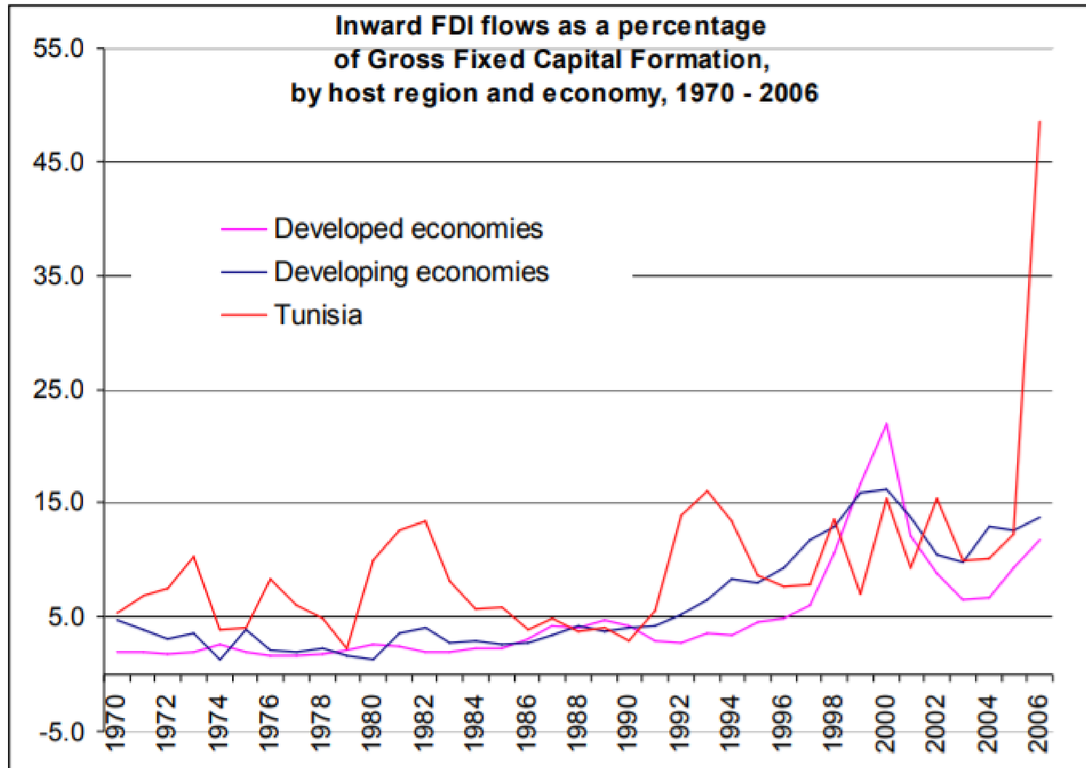
Figure 7 and 8:





FDI flows to Tunisia, in 2002, reach a height since 1990 and almost double the total inflows recorded in 2001. The FDI inflows to Tunisia in 2002 were determined by investment in oil exploration activities and manufacturing sectors. The peak was reached by a fourfold increase from 2005 to 2006 (totalling $3.3billion). FDI outflows, on other hand, were small throughout the last decades touching the maximum of $33 million in 2006 (Figure 12). Inward FDI stock grew from $11.7 billion in 2001 to $14 billion in 2002. Outward stock also increased from $33 million in 2001 to $37 million in 2002 gradually rising over the past years (Figure 13). Yet, outward stock and flows are a visibly tiny fraction of inflows and its corresponding stock.

Figure 9:



As a percentage of the gross fixed capital formation, FDI inflows has grown in importance from 9.3% in 2001 to a little over 13 % in 2002 hitting the rather extreme level of 46.6% in 2006. For outflows, it was insignificant and indicated levels of between 0.0% and 0.5% of GFCF in 2006 (Figure 9)

Discussing the Net Outward Position (NOP) In order to determine the IDP stages of each country, changes of NOP (alternatively Net Outward Investments NOI) position with respect to GDP level for each country are analysed. In the explanations beforehand it was mentioned that at the first stage of IDP a negative NOI is accompanied with a low GDP level. As the inward FDI increases, the NOI level of the country tends to decrease and the GDP level to rise relative to the first stage.

A country shifts to the third stage of IDP when its outward FDI begins to increase while its inward FDI growth rate decreases and the NOI level of the country tends to rise with respect to the change in its GDP level. At the fourth stage of the IDP, a country's outward and inward FDI levels become equal initially and later the outward FDI exceeds the inward FDI. Therefore, the NOI level of the country increases to positive values. The fifth stage is characterised with rising levels of both inward and outward investment and the NOI level fluctuates around zero. Appendix V shows the NOI position of selected MENA countries' with respect to their GDP levels.

Referring to a study done by Divarcy et al. 24 Algeria, Morocco, and Tunisia are at the second stage of IDP due to their increasing inward and low outward FDI - thus a decreasing NOI level. However, the NOI and GDP scatters (Appendix V) do not allow one to make a prediction about their IDP stages. For example, Libya has negative inward FDI over the period, i.e., the foreign investors have disinvested in the country after the UN sanctions. Also, the political environment of Iran might have

prevented FDI inflows since NOI position of the country is close to zero. In Kuwait, inward FDI is very low compared to outward FDI stock of the country therefore the NOI position of the country demonstrates positive values for the period considered.
Although the scatter diagrams suggest that Algeria, Morocco and Tunisia are at the second stage of IDP, the empirical results do not support this observation for Algeria. Qatar, which has mostly eliminated FDI restrictions and strengthened legal protections, has location advantages depending on its natural resources. Tunisia is a little different from Qatar; they have attracted increasing FDI inflows to industries such as tourism, automobiles, electronics and infrastructure (UNCTAD, 2004). They have recently begun to attract efficiency-seeking FDI in such industries as textiles and apparel. This change can be interpreted as a sign of moving to the third stage of IDP particularly in some industries. Qatar poses a good portrait with its political stability, relatively well developed infrastructure and an efficient stock market as far as location advantages go.

FDI From the EU to the Maghreb:

The European Union's FDI positions in the MPC more than trebled between 1996 and 2000. In the latter year, Turkey, Egypt and Morocco alone accounted for nearly 60% of European FDI in the MPC countries25. In absolute terms, the FDI positions in the Maghreb and Mashrek26 countries were almost identical in 2000. But when the size of each country's economy is taken into account (as a percentage of GDP), the presence of European firms is much more noticeable in Maghreb countries, especially Morocco, than in the Mashrek Countries and (Table 3). Among the Member States, the Netherlands, France and Germany were the main providers of FDI in the region. French firms tended to invest in the Maghreb countries, while Dutch and British firms were more likely to invest in the Mashrek countries (Table 3).

Table 1

EU FDI Stocks in MPCs in 2000 (EUR mio.)

	Extra-EU	CC-13	MPC-12	Maghreb	Mashrek	Morocco
EU-15	1517186	75326	22936	6420	5353	3285
Germany	249647	24095	3138	437	364	212
France	232815	7607	3626	1711	654	1252
Italy	67958	4923	2609	903	264	281
Netherlands	161993	10353	3731	310	1671	81
Portugal	12064	247	1259	754	504	316
UK	442860	3967	-	260	1476	74
Switzerland	127289	-	-	222	485	193
USA	737771	-	10734	2574	2622	39

At around EUR 23 billion, the European Union accounted for more than twice as much FDI in the MPC countries as the United States in 2000. As in the case of the EU, American FDI positions have risen sharply since 1994 but they are still low when compared with other parts of the world, especially South America or Asia. The main destinations for American FDI in the MPC countries were rather Mashrek countries, especially Egypt (Table 3) The EU has traditionally run a large FDI surplus with

regard to the MPC countries. Direct investment by the MPC countries in Europe in 2000 amounted to EUR 7 237 million (Table 1).

	EU-15	D	F	I	NL	UK	USA
MPC-12	7237	1090	1040	441	838	942	-
Maghreb	1051	-	547	59	2	-	-25
Mashrek	784	12	272	193	12	128	-5
Morocco	539	0	256	38	-	-	-25

Throughout recent year, France was a key player in terms of FDI flows to Maghreb (Appendix VI). Out of all EU countries, France had the most stable investment flows whereas Morocco was the main beneficiary. Apart from France, investments above $10 million p.a. were realized by Spain, the Netherlands, the UK, Italy and Germany.

Conclusion:

Due to recent changes in trade and investment policies between the EU and Maghreb, an investigation of FDI was deemed essential to shed light on the rather poor performance of MENA countires and North Africa in particular. Throughout this study, several aspects of Maghreb countries were portrayed while particular focus was placed on the interlinkage between macro economic policies and FDI. As research topic, the Mediterranean area is a hot spot where socio-political tensions exist and limited knowledge about governance, investment policies and related trade regimes is available. To analyse the chosen region, the thesis is built on a country-based methodology and follows a macro-level approach analysing FDI flows to answer the research questions. In many ways have investment policies and trade patterns affected FDI. Those initial agreements in Barcelona in 1995, sparked little by little reforms in Maghreb countries. Even though Maghreb countries may still be regarded as highly protected, more trade and FDI flows are obvious. Comparing the three countries, Algeria appears to be the least diversified in terms of trade. Morocco and Tunisia trade with a broader base of EU members and offer more variations for investments. However, a high dependency on Europe's progression (France in particular) illustrate that this can only be the beginning of a deeper global integration. To climb up the stages of the IDP a stronger business economic base has to be established so that more stable outflows and inflows emerge.

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