Distr. : LIMITED

ECA/TNG/SRDC/DMIT/SEM/11

Original: ENGLISH

UNITED NATIONS

ECONOMIC COMMISSION FOR AFRICA

**Sub-Regional Development Centre
For North Africa (SRDC)**

Seminar on Debt Management, Investment and Trade in North Africa

Tangier, Marocco, 9-12 November 1999

Foreign Direct Investment in North Africa

Overview

INTRODUCTION

Many developing countries have been seeking to attract foreign direct investment not only as a source of external private finance to complement domestic investment, but also as a means to contribute to the building of indigenous capacity and technological capability through the transfer of technology and skills. To this end, policy makers in North Africa have adopted policies aimed at providing various incentives to attract FDI. However, these policies appear to have not capitalized sufficiently on the potential benefits of FDI. There is a considerable difference in the way those incentives have succeeded in attracting FDI to the region as a whole, which has been relatively low in terms of productivity and too heavily dependent on external factors. Private capital inflows have shown more diversity and response in countries that have made steady progress in consolidating macroeconomic stabilization and intensifying reforms seeking to enhance private investment and production efficiency.

TRENDS

FDI inflows to North Africa – at $2.64 billion in 1998 – were down from a high of $3.05 billion in 1997. This was largely due to a sharp fall in flows into Morocco where privatization-related FDI, which reached a pick level in 1997, fell significantly in 1998. The fall of FDI inflows to Morocco could not be offset by the rapid growth of FDI in Egypt and Tunisia, which together accounted for about two thirds of FDI inflows to the region in 1998. In Egypt, a notable increase in FDI inflows to $1.08 billion was directly due to increased flows into manufacturing, which accounted for about half of total FDI flows in 1998. Other activities that have drawn great interest were in tourism, electrical and electronic plants, building materials, engineering, food, metals and textiles. The growth in inflows registered by Egypt, combined with that registered in Tunisia, helped to maintain a relatively high level of FDI inflows, compared to previous years (except in 1997) (see figure 1).

Notwithstanding their significant year-to-year fluctuations and in spite of significant improvements in recent years, much of North Africa's potential for FDI remain unfulfilled. While there are significant differences across the countries of the region in the importance and characteristics of FDI, in general the volume of FDI remains limited in absolute terms and relative to the size of the economies. Since the early 1980s, FDI inflows to North Africa have been lower than other regions, except sub-Saharan Africa.

North Africa has benefited from the rise in FDI flows that characterized the period 1990-1998, though to a much lesser extent than other developing countries. The share of North Africa in total FDI inflows to developing countries fell from an average of 3.4 per cent during the period 1987-1992 to a mere 1.6 per cent in 1998. This large decrease in North Africa's share of developing countries is largely explained by the exceptionally strong FDI performance of Latin America and East Asia.

Over the past five years (1993-1998), cumulative FDI inflows to the region amounted to about $12.6 billion. Among North Africa, the distribution of FDI inflows is extremely uneven - in terms of both countries and activities. In 1998, for example, Egypt received 41 per cent; Tunisia, 25 per cent; Algeria, 19 per cent; and the other 4 countries (Libyan Arab Jamahiriya, Mauritania, Morocco and Sudan) combined, 15 per cent (see figure 2). The value of FDI inflows to the region amounted to an average of about 1.1 per cent of GDP, a rate that is lower than in most other developing regions. Not only has the level of FDI in North Africa been poor when compared to other fast-growing developing countries, its efficiency appears to have been relatively low.

This poor performance in the attraction of FDI to the region was, in part, the result of political and macroeconomic volatility, a lack of strong commitment to privatization, and various negative features of the business and economic environment, including barriers and limitations to foreign ownership and participation. To some extent, however, the low level of FDI flows to the region was affected by external factors, most notably the sharp decline of international oil prices. The shrinking of oil- and oil-related investments, particularly in Egypt, Libyan Arab Jamahiriya and Tunisia has lowered the growth of FDI inflows. Recent improvement in the macroeconomic and political environment is likely to allow some pick up in FDI. However, the bulk of foreign investment is expected to result from privatization, tourism, textile and, to a lesser extent, in the petroleum sector. Plans to expand the production capacity of oil in Algeria, Egypt and Sudan, will encourages further petroleum FDI in those countries.

INVESTMENT POLICIES AND DETERMINANTS OF FDI

The poor outlook for a rapid economic growth, combined with the tight fiscal balance in most of the countries of the region have added momentum to those countries' efforts to diversify their economy and rely more on the private sector and foreign investment. In principle, most countries actively encourage foreign private investment, especially in sectors, which are export-oriented and do not compete directly with established local firms. In practice, however, most of them have been relatively less open to foreign investors. Foreign investment in most of those countries has been allowed, but only in selected sectors.

While foreign investment in the region has been limited, opportunities for foreign investors appear to be emerging. There is a movement underway to expand the investment incentives available to foreign investors. Prospects for increased FDI inflows into North Africa have improved, as illustrated by the results of a survey conducted by UNCTAD for the World Investment Report 1999 (WIR99) of 44 African investment promotion agencies (IPAs). Of the four IPAs from North Africa that responded, all indicated that FDI prospects for the period 2000-2003 for their own country, as well as for Africa in general, are expected to improve. In terms of the factors that are likely to contribute positively to foreign firms' decisions to invest in developing countries, the profitability of investments, the regulatory and legal framework and the political and economic outlook for FDI were most frequently mentioned by most investment promotion agencies. Access to regional markets, trade policy, tax regimes, as well as access to low-cost skilled labour were also factors cited by many respondents. In terms of the factors with negative influence on foreign firms' decisions to invest, extortion and bribery, as well as high administrative costs of doing business and access to capital were most frequently mentioned.

According to the survey, many investment promotion agencies are optimistic about attracting greater share of FDI inflows in the near future. They identified a number of policy changes necessary to further attract FDI. These include areas related to stabilization of the political situation, macroeconomic stabilization, deregulation of the economy and privatization, business and administrative facilitation measures.

A legal framework and a relatively conducive macroeconomic environment for foreign investment in most countries, particularly in Algeria, Egypt, Morocco and Tunisia already exist. A legal system that governs foreign investment, including labor laws, company laws, intellectual property rights and other measures, such as repatriation of profits and capital are guaranteed and few sectors are barred to foreign investors. FDI flows to these countries are increasingly going into manufacturing and Tourism. FDI inflows, particularly in Algeria, Libyan Arab Jamahiriya and Sudan, have been hampered by the lack of privatization, as well as by sanctions (in the case of Libya and Sudan).

In spite of the progress already made to create a business-friendly environment, FDI in dynamic industries, such as manufacturing and electronics, is unlikely to pick up sharply before policy makers of the region pay more attention to the real incentives that attract transnational corporations and enable them to maintain their competitiveness. With liberal policy frameworks as well as financial and fiscal incentives that are used to attract foreign investors becoming commonplace in many fast-growing developing countries, other economic measures have emerged as the most important determinants for the location of FDI. The most important of these determinants relate to the size of markets for goods and services, to the availability of location-bound resources or assets and to cost advantages in production. Other incentives for FDI that are particularly needed in North Africa include policies that foster macroeconomic stability and predictability; openness in the economy; reduction in the bureaucracy; a tax regime which encourages equity and direct investment financing; and an investment policy which encourages the private sector to participate in infrastructure building and other sectors, such as health, education, roads, and electricity generation.