Executive Summary

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. Global foreign direct investment (FDI) flows fell by 50% in the first half of 2020 compared to the preceding six months, and the OECD predicts world economic output to contract by 4.2% in 2020. The effect on MENA economies could be even greater. FDI inflows to the region declined sharply in 2020, and forecasts suggest a significant economic contraction ahead, with sharp increases to already high unemployment and poverty, as well a rising risk of macro-economic, political and social instability.

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. The MENA economies covered in this report are diverse: Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, the Palestinian Authority, and Tunisia each face unique obstacles, opportunities and goals. Many of these countries nevertheless share common challenges. The report offers reform proposals, considering several policy dimensions that affect the investment climate, and places strong emphasis on how investment can help MENA governments improve the lives of their citizens.

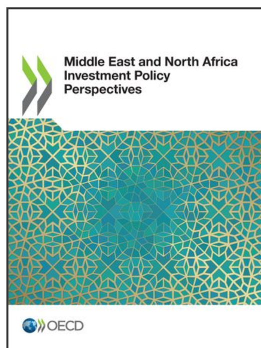
A common challenge: making investment work for sustainable development

Recognising the positive role investment can play in supporting development goals – from economic diversification to creation of 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.

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. In most MENA economies, there is a popular perception that investment has not benefited the average citizen. Despite notable reforms, many areas of the investment climate continue to pose challenges to investors and private sector growth more broadly, limiting the positive impact of investment.

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

- **Improve the clarity, consistency and transparency of investment rules and procedures.** MENA economies 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, whether perceived or real, which can create confusion for investors. 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. Authorities in most MENA economies have wide discretion to determine tax incentives, and in some cases, in deciding which investors can enter the market and receive permits and land. Greater specificity in laws and regulations, which reduces scope for interpretation, might contribute to limiting corruption, unfair competition risks and potential investor-state disputes.
- **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. Limiting FDI in key services, such as transport, 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. FDI restrictions in services also limit participation in global value chains (GVC). Gains from GVCs, such as knowledge transfers, have been limited. 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.
- **Target investment policy and promotion to better serve sustainable development goals**. MENA governments may have to re-think investment promotion strategies, both to respond to new 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 high development impacts 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 the national context 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. This includes advancing human and labour rights, gender equality and environmental protection in business activities and their supply chains.
- **Strengthen good governance and co-ordination to deliver better investment policy**. MENA governments have undertaken numerous reforms of their institutional framework for investment, boosting the roles of 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, while sharing responsibilities between national and subnational bodies could improve policy delivery. Lastly, MENA governments could further solicit investors' and other stakeholders' views when developing policies; facilitating an environment of trust and accountability between the government and business community is especially important in uncertain times.



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