12 Investment policy in fragile contexts

Fragility and crises are pervasive elements in some parts of the MENA region, weakening the potential of some countries to attract investment. This chapter discusses how the different dimensions of fragility affect investment in the focus economies, and outlines policy considerations to overcome challenges in attracting and retaining FDI. It presents the main drivers of fragility and explores their complex relationship with FDI. While fragility and crises may discourage investors, FDI is a crucial source of growth and financing to strengthen resilience in fragile scenarios.

Summary and policy considerations

Foreign direct investment (FDI) can be an important source of financing, driving job creation, technological advancement and private sector development in the MENA economies covered in this report (MENA focus economies). This chapter analyses the fragility challenges that some of the focus economies face, and provides policy considerations for overcoming barriers to attracting and retaining quality investment. Given the diversity in the region – from higher levels of fragility in Libya, Syria, the Palestinian Authority (PA), and increasingly Lebanon, to greater stability elsewhere – the implementation of these policy considerations would vary across the MENA focus economies.

Fragility is a multidimensional concept that affects the focus economies in different ways, to different degrees. While only two of the focus economies (Libya and the PA) appear among the most fragile 57 contexts on the OECD fragility framework, all governments are to some extent faced with fragility issues[1]. Analysis of the OECD's five dimensions of fragility indicates that the political and societal dimensions of fragility are the most salient across the focus economies, while the economic, environmental, and security dimensions affect them to varying degrees.

More broadly, the larger Middle East and North Africa (MENA) region[2] is one of the most fragile regions in the world, second only to Sub-Saharan Africa, and these security and fragility risks can bleed out to affect risk perceptions throughout the region. Macroeconomic and political instability, high levels of popular discontent, movements of forcibly displaced people, the social and economic effects of desertification and environmental degradation are problems that most governments in the region have had to confront in recent times.

The relationship between fragility and investment is complex. In affecting the return and risk considerations of foreign investors, fragility can have serious negative implications for FDI inflows and retention, and can encourage the concentration of FDI in heavily protected enclaves, distinct from the national economy. Fragility is costly for investors, even in the absence of outright conflict. At the same time, investment can help to address some of the underlying drivers of fragility by providing necessary sources of financing and contributing to inclusive and sustainable economic and social development. However, FDI in the focus economies is largely concentrated in low-productivity and low-employment sectors, limiting its ability to contribute to economic and social resilience (Chapter 2). On some occasions, certain investment projects can even exacerbate fragility risks, especially in cases where monitoring and regulatory enforcement capacities are low (Chapters 10 and 11).

Nevertheless, government policy and private sector investments can affect whether and how fragility risks negatively affect FDI, and the degree to which investment positively contributes to stability. Fragility analysis can be an opportunity to support FDI: the appropriate response depends on the nature and degree of fragility in a given context, and should be tailored as such. An understanding of fragility also reinforces the importance of priorities – such as improvement of the policy environment for investment and responsible business conduct (RBC) – that are outlined in other chapters.

In implementing policy responses, governments should adopt approaches that reflect the complementarity between investment promotion, resilience and inclusive development priorities, and – where relevant – seek support from development partners. Risk mitigation tools can help overcome some of the risks that constrain investment attraction. In this regard, blended finance approaches, as well as political risk insurances provided by public and private bodies (from development partners to export credit agencies), are relevant. Promoting business linkages between domestic and international firms, integrity and responsible business conduct can also contribute to decreasing risks and enhancing investors' trust (Chapters 8, 10 and 11). Governments supporting FDI in the face of fragility can develop tailored approaches to investment promotion, notably with respect to investor and sectoral targeting, but also by elaborating strategies based on proactive approaches, effective communication, efficient after-care services and grievance mechanisms (Chapter 6).

Policy considerations

- Enhance the overall investment environment using a fragility lens, recognising the complementarity between attracting investment and promoting resilience and inclusive development. Policymakers can adopt approaches that address the different dimensions of fragility, and align investment strategies and objectives with national development priorities, resilience and inclusiveness. Development partners can be recruited to assist governments in addressing the linkages between FDI and fragility in a holistic way.
- Demonstrate political commitment to legal stability, while laying the foundations for a sound legal investment framework. Solid and transparent investment protection provisions are ever-more essential to address investors' concerns in economies that are exposed to fragility. The international legal investment framework can also bring additional guarantees to investors, but breaches have increased during periods of instability, leading to complex and costly investor-State disputes. Governmental awareness of these risks, institutional co-ordination and investment dispute management and prevention mechanisms are needed to address the sensitive and complex issues of investment protection.
- Consider the adoption of measures and tools that contribute to mitigate real and perceived risks to investment. Promoting business linkages, integrity and responsible business conduct are key to increase the familiarity, penetration of foreign investors, and decrease uncertainty, while contributing to the overall positive impact on the economy and society. Additional tools include risk transfer mechanisms like political risk insurance and export credit finance, as well as blended finance approaches crowding-in private funding through public guarantees, PPPs, equity investment or debt instruments.
- Develop investment promotion approaches tailored to fragility. This includes adopting proactive mechanisms centred on institutionally strong and well-resourced IPAs, targeting investors that are more familiar with fragility and the national context, as well as prioritising strategic sectors with positive social and developmental effects that may help in mitigating the drivers of fragility itself.

The complex relationship between fragility and FDI

By increasing the risks and costs faced by international investors, fragility can discourage investment decisions, FDI inflows, reinvestment, and retention. Fragility is multidimensional and affects the focus economies in different ways, with some dimensions of fragility – for example, political and economic fragility – appearing to have a greater effect on FDI than others.

Yet, investors do invest in even highly fragile economies, and investment and fragility interact in complex ways. While FDI can be an important positive contributor to development and stability, there are cases where individual investment choices appear to exacerbate fragility and do not respect RBC. With the right policies and private sector actions, there are opportunities for investment to contribute to stability and resilience through positive developmental, technological and human capital spillovers.

This first section presents the framework that the OECD uses to assess fragility, outlines the relevance of fragility and synthesises the main fragility challenges present in the focus economies and the MENA region more broadly.

Fragility is multidimensional and affects the focus economies to different degrees

Fragility can be measured in many ways, and historically has often been perceived in terms of the presence or absence of conflict. Increasingly, however, fragility is seen as a multidimensional set of issues that affect all economies and countries in varying ways (Box 12.1) (Desai and Forsberg, 2020[1]).

It is important to stress that fragility is not a binary concept between “fragile country” and “non-fragile country”. The OECD characterises fragility as “the combination of exposure to risk and insufficient coping capacities of the state, system and/or communities to manage, absorb or mitigate those risks” (OECD, 2020[2]). In this sense all countries and economies are fragile in some way, to some degree.

Fragility can lead to negative outcomes including violence, poverty, inequality, displacement, and environmental and political degradation. Identifying these risks, even before the outcomes are apparent, can help inform the ways in which governments and other actors can bolster resilience, with positive impacts for the investment climate.

Using the OECD fragility framework, fragility is measured on a spectrum of intensity across the economic, environmental, political, security and societal dimensions. A sixth dimension – human capital – will be added to the framework in 2022. Each dimension is represented by 8-12 indicators – 44 in total across all 5 dimensions – that measure fragility risks and government coping capacities to manage or mitigate these risks (Desai and Forsberg, 2020[1]). In doing so, the OECD multidimensional fragility framework captures the intersection of fragility, risk and resilience to inform where and how the root causes of fragility in each dimension can be addressed over time.

Globally, 175 economies have been analysed against the 2020 edition of the fragility framework.[3] Among the focus economies, Libya and the PA are among the most fragile 57 countries and territories – referred to as contexts – that are profiled in the *States of Fragility 2020* (OECD, 2020[2]). Of these 57 contexts, 13 are extremely fragile and 44 (including Libya and PA) are other fragile contexts. While most of the MENA focus economies are not among these 57 contexts, all exhibit some aspects of fragility. This fragility analysis, discussed here and shown in the Annex, has revealed useful findings to inform policies across the focus economies. Recent events, such as the political and economic crisis in Lebanon, have further revealed aspects of fragility in the region not fully captured in this data, the majority of which is from 2018. The Covid-19 health and economic crisis has exacerbated all dimensions of fragility around the world, with rising food insecurity, social inequalities (UN Women, 2020[3]; UNDP, 2020[4]), political violence and breaches of democratic norms and standards, especially in fragile contexts (Edgell et al., 2020[5]). Globally, an estimated 150 million people will be pushed into extreme poverty by 2021 (World Bank, 2020[6]).

Box 12.1. Fragility is about more than just conflict, economic performance or governance

The OECD’s fragility framework analysis reveals that the drivers of fragility are much more complex and diverse than just conflicts, weak governance, or poor economic performance. They encompass a range of factors exacerbating stability and undermining sustainable development. While the economic dimension is an important factor in fragility, evidence shows that moving up the income ladder does not necessarily reduce entrenched fragility, nor does strengthening government institutions alone (OECD, 2018).

For example, while more than 80% of the world’s poorest could be living in fragile contexts by 2030, 30 out of the 57 economies included in the 2020 OECD States of Fragility report are classified as middle income. And not all fragile contexts have active, or even recent, conflicts (OECD, 2020). There are no one-size-fits all solutions for fragility, so to be effective, approaches need to take account of the types of fragility seen in each context.

Fragility and investment interact in complex ways

FDI can be an important source of financing, job creation, technological advancement and private sector development for economies in the MENA region. It can help to mitigate fragility and promote inclusive social and economic development. Nevertheless, private investment should not be seen as a panacea. Fragility can stand in the way of achieving sustainable, quality investments by increasing the costs and risk exposure of international investors. If policymakers do not take account of the potential risks, investments hence miss the opportunity to contribute to development, or even exacerbate fragility.

Investment can help to mitigate elements of fragility

FDI can play a pivotal role in providing necessary financing to address fragility across its different dimensions. This is especially relevant considering the macroeconomic constraints, limited domestic private investment levels, and in some cases ODA dependence, that many economies face.

Increasing foreign investment is not purely about volumes of financing to the private sector, it should also promote economic resilience and inclusiveness. The sectoral distribution of FDI is thus particularly important: FDI can increase jobs, local income and productivity, and advance social goals, including through investment into sectors such as healthcare, education, and digital services. Using data from the Social Progress Index of social and environmental health of societies, Deloitte (2015[7]) found a positive relationship between FDI per capita and social progress across a sample of 132 countries, though the nature of this relationship varies according to country and sector. Additionally, input-output linkages with the local economy, including with local SMEs, can strengthen economic resilience by promoting private sector development.

Governments should therefore concentrate their efforts on attracting investment that can have a higher development impact by targeting sectors that contribute to creating a suitably skilled-workforce, and encouraging spill overs. Foreign companies should also act responsibly to generate higher impact for the host economy. Insights from private sector activities in the most fragile and conflict-affected contexts show that there is a positive business case for responsible investment in these economies, although this requires companies to see the benefit in adapting their core operations to manage the risks fragility presents and improve their impact on society (WEF, 2016[8]). When this is indeed the case, it may generate returns for the companies, local communities, and governments alike (*ibid*.).

Fragility and conflict, where present, can limit FDI and encourage FDI enclaves

Instability and conflict can reduce investor confidence and further compound protracted economic and political fragilities. This is particularly, though not exclusively, relevant in economies showing relatively high fragility in the security dimension, such as Libya and PA (see Annex A). For example, based on the World Bank Group's classification of Fragile and Conflict-Affected Situations (FCS),[4] the IFC (2019[9]) found that even though the potential for FDI in FCS is lower than in more stable contexts due to small markets and low levels of trade, under conditions of peace and stability FDI flows to FCS would be at least twice as high as is currently the case.

Nevertheless, even severe fragility and conflict do not affect all investors alike, depending on the stage in the investment cycle or the sector (Barry, 2018[10]). Evidence suggests, for example, that resource-seeking FDI (e.g., in natural resource-intensive and extractives industries) is not particularly deterred by political instability or even conflict. FDI in natural resources is relatively insensitive to political instability (Chapter 2), driven in the region by a few mega-projects. Analysis using the Fragile States Index of the Fund for Peace showed that among countries with the highest level of fragility, FDI as a proportion of GDP was highest among resource-dependent countries, higher even than the average in low- and middle-income countries (Jensen, 2020[11]). Alongside natural endowments and global commodity prices, resource-seeking FDI in such situations is more likely to be determined by the extent to which production facilities and export infrastructure can be protected from current and future conflict, whether in offshore processing facilities or through onshore security measures (Jensen, 2020[11]; Multilateral Guarantee Agency, 2011[12]).

In some of these cases, however, overall positive FDI figures may hide its limited impact on resilience and sustainable development due to its structural and sectoral composition. While the employment outlook is varied and may be more positive in minerals, renewables, and agriculture, some natural resource investments – for example in mining and oil – may effectively operate in FDI enclaves with few linkages to the rest of the economy, generating relatively few jobs. This risk may be higher where investments are capital intensive rather than labour intensive (as is the case for most energy investments), require specialist training that local populations do not have access to, where they require few inputs from the local economy or local companies may not be set up to act as suppliers (UNCTAD, 2012[13]; Cordes, Östensson and Toledano, 2016[14]; Thompson, 2020[15]).

Fragility is costly for investors, even in the absence of conflict

Even in the absence of open conflict, fragility can discourage investment decisions, FDI inflows and retention by increasing the risks – actual and perceived. Studies indicate that some aspects of fragility have a greater negative impact on investment than others (Thompson, 2020[15]). Besides economic upheaval, political risk[5] can heighten investor concerns, whether due to increased protectionism, regulatory instability, policy uncertainty around Covid-19, or concerns about governments' ability to fulfil sovereign and contractual obligations or maintain currency convertibility (Kher and Chun, 2020[16]). FDI inflows also appear to be reduced by factors like low institutional quality (Alfaro, Kalemlio-Ozcan and Volosovych, 2008[17]) and high levels of corruption (Wei, 2000[18]).

Managing and mitigating these risks through, for example, political risk insurance (see below), increases the cost of doing business. Indeed, a global survey of international investors shows that political risk is the most important factor affecting investment entry decisions (Kher and Chun, 2020[16]). This includes fears on sudden political changes, uncompensated expropriations, breach of contracts, unfair treatments or discriminatory measures, abrupt regulatory changes (e.g., on licensing, tax, environmental requirements, etc.) and lack of transparency.

Recent studies show that investment in the MENA region is particularly sensitive to fragility in its political and security dimensions (Caccia, Baleix and Paniagua, 2018[19]; Dimitrova and Triki, 2018[20]). Moreover, quantitative analysis shows that higher political risk, especially in relation to conflict and institutional quality, increases the cost of equity capital for firms operating in the MENA region (Belkhira, Boubakrib and Griraa, 2017[21]).

On some occasions, investments can exacerbate risks to stability that need to be managed

The positive contributions of FDI to resilience, economic and social development are important, but not automatic. Investment is not a panacea, and its positive impact on sustainable development depends on a number of factors, including good policies, strong institutions and appropriate human resources (Li and Tanna, 2019[22]). Where State monitoring and regulatory enforcement mechanisms are weak, the possibility arises for FDI to have a negative impact on stability, whether through communal violence, poor working conditions, environmental degradation or increased corruption opportunities.

There have been cases globally where investments have been linked to increased fragility, especially in the extractives sectors. In sub-Saharan Africa, for example, (Christensen, 2018[23]) mining investments double the risk of protests and riots around the site, which are more likely when commodity prices increase, and in environments where the state is absent in negotiations between mining companies and local/host communities. In the Democratic Republic of Congo, even during conflict, the proximity of an AngloGold Ashanti mining site to a peace-keeping operation helped provide reassurance for the resumption of mining exploration. But this also involved engagement with and payments to the militia involved in the conflict, and the company was accused by Human Rights Watch of indirectly fuelling the ongoing conflict (Multilateral Guarantee Agency, 2011[12]).

Government policy and responses to fragility can help to determine whether FDI exacerbates fragility risks or reinforces coping capacities. High societal and security risks, high levels of unemployment and social instability may lead governments to adopt, willingly or not, behaviours that are even more detrimental for investors and increase this negative impact (WEF, 2019[24]). Christensen (2018[23]) argues that poor information flow can lead to mismatched expectations between the investing firm and the local population, which governments can help mitigate through greater transparency and institutions that can mediate between local communities and investors. In the case of Liberia, geo-spatial analysis supported the governments' decision to use a 'development corridor' approach, whereby agglomeration affects and the provision of public goods ensured that mining concessions support positive economic growth and development in the surrounding areas, even in the face of high levels of fragility (Bunte et al., 2018[25]).

The concrete risk that international investors could exploit a lack of state capacity has inspired international efforts to promote due diligence and responsible business conduct, particularly in sensitive sectors (Chapter 10). The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, for example, provides recommendations on how companies can avoid contributing to conflict through their mineral purchasing operations in these contexts. Recently, the OECD Due Diligence Guidance inspired EU due diligence obligations for importers of minerals originating in high-risk areas, effective as of January 2021.[6]

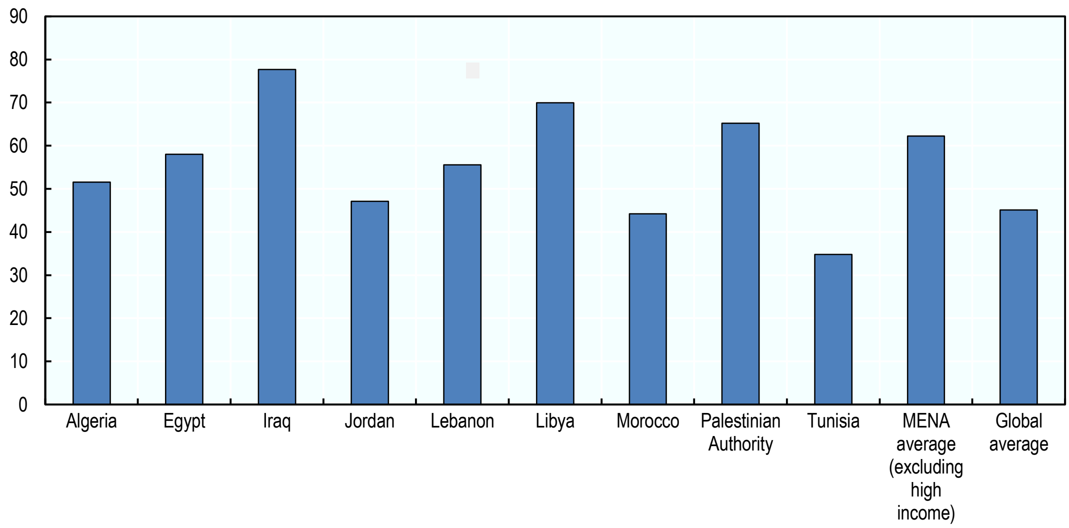
The five dimensions of fragility in the focus economies

Among the focus economies, Libya and the PA are among the most fragile contexts profiled in the 2020 OECD States of Fragility report. Egypt was profiled in the 2018 States of Fragility report but has increased its resilience and decreased fragility since then. Egypt reduced its fragility in every dimension except in the security dimension, achieving significant declines in political and societal fragility (OECD, 2020[2]).

In terms of aggregate regional fragility, the larger MENA region, excluding high income countries[7] is one of the most fragile regions in the world, second only to Sub-Saharan Africa (OECD, 2020[2]). Since 2011, the outbreak of the Syrian conflict has had unprecedented economic and political repercussions in the region with 5.6 million refugees flowing to neighbouring countries, including Lebanon and Jordan (UNHCR, 2020[26]). This situation has further compounded pre-existing fragilities in refugee-hosting countries, especially in Lebanon, which has experienced a profound economic and political crisis in 2020.

Fragility remains highly relevant to investment policymakers in the focus economies, even those with lower levels of fragility. For example, the macro-economic issues symptomatic of economic fragility – such as high levels of debt or aid-dependency – are common to several countries in the region. Almost all governments in the region have been confronted by political instability, movements of forcibly displaced people, the social and economic effects of desertification and environmental degradation and high levels of popular discontent. In terms of security, a surge of violence or conflict elsewhere in the MENA region can prejudice perceptions throughout the region (Caccia, Baleix and Paniagua, 2018[19]). Using the OECD's multidimensional framework, Figure 12.1 provides an aggregate indicator of fragility across the focus economies. Indicators for Iraq, the MENA regional average (excluding high income economies) and a global average are included for comparison purposes.

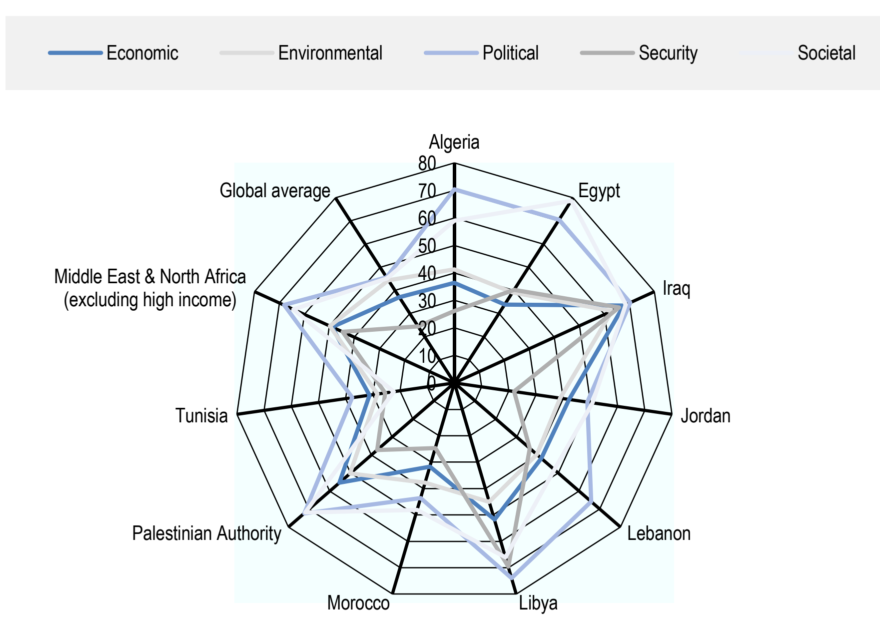
Figure 12.1. Fragility varies across the focus economies



Note: This indicator has been scaled, with 0 indicating and 100 indicating the lowest and highest values of fragility, respectively. Figures for Iraq, the MENA average (excluding high income) and the global average are included for comparison purposes.
Source: Desai and Forsberg (2020). Data provided directly to the authors.

The OECD's multidimensional framework covers the five inter-related dimensions of economic, environmental, political, security and societal fragility. While each focus economy is unique, OECD quantitative analysis indicates that the political and societal dimensions of fragility are the most salient in the focus economies (Figure 12.2). The following sections look further across the five dimensions and their relevance to investment policymakers in the focus economies.

Figure 12.2. Political and societal dimensions of fragility are the most salient in the focus economies



Note: 0 and 100 indicate the lowest and highest values of fragility, respectively.
Source: Desai *and Forsberg (2020). Data provided directly to the authors.*

The political dimension of fragility

The political dimension of fragility encompasses a country's mechanisms for mediating economic and social relationships – including those relevant for investment – and its capacity to strengthen accountability and transparency. Political fragility affects other dimensions by shaping the institutions that are key to supporting a sound investment climate, as well as inclusive societies. Indicators of the political dimension of fragility include clientelism and corruption, government effectiveness, division of power, constraints against the executive, physical integrity, voice and accountability, and women's participation in parliament. Political fragility can mean that the legal and regulatory context for international investment can be unstable and bring additional risk for investors.

The greater MENA region exhibits the highest level of political fragility among all regions of the world (OECD, 2020[2]). This is mirrored by data pointing to low trust in governments in the region. In Lebanon and the PA, for example, 80% and 50% of respondents to a recent survey reported have little to no trust in government (Transparency International, 2019[27]). Political fragility can be caused by endogenous factors, like lack of voice and accountability, social unrest, terrorism and poor institutional quality, as well as exogenous factors like conflict in neighbouring countries.

In the aftermath of the 2011 uprisings, some governments in the region have experienced major political transitions, including constitutional reforms. While some focus economies have increased their relative stability in this respect, political stability goes beyond stable and highly centralised states. The functioning of regional governance for example (i.e., the presence, level of autonomy, and effectiveness of elected public officials at the subnational level), as well as appropriate legislative and judicial constraints on the executive play, can play an important role in mitigating political fragility by promoting pluralism, local accountability, and mediating potential conflicts.

Among the focus economies, political fragility remains one of the most salient dimensions of fragility. Demonstrations of popular discontent in Algeria, Lebanon, Egypt, Morocco and Tunisia in particular have made increasingly clear that widespread corruption and territorial inequalities on the one hand, and accountability on the other, are intrinsically linked to the political dimension of fragility. Although corruption levels vary, international indicators point that none of the focus economies received a "passing grade" of 50/100 in terms of integrity (Chapter 11).

The societal dimension of fragility

The societal dimension of fragility comprises a country's vulnerability to risks affecting social capital and cohesion, especially in relation to inequality and access to opportunity, as well as the institutional capacity to mitigate these risks. Societal fragility exacerbates economic, political, and social exclusions and contributes to worsen the situation of marginalised communities.

In this dimension again, the greater MENA region excluding high income countries presents the highest level of fragility compared to other regions (OECD, 2020[2]). Youth unemployment is particularly severe across most of the focus economies: 50% in Libya, 41.6% in the PA, 36% in Tunisia, and 36% in Jordan (World Bank, 2020[28]). Although the total unemployment rate is estimated to be relatively low in Lebanon (6.3%), this is three times as high among young people (*ibid.*). High levels of unemployment, especially among youth and women, represent a major threat to social cohesion (ILOSTAT, 2020[29]). Globally, poverty and a lack of socio-economic opportunities are especially common among internally displaced people and refugees, which the focus economies host in large numbers (OECD, 2019[30]).

In the greater MENA region, the proportion of young people who are not in education, employment, or training (NEET) exceeds those in all other regions of the world (OECD, 2018[31]). Low scores on women's participation in the labour force, and on the proportion of NEET are common across the focus economies, with NEET rates among women surpassing 40% in Egypt, Jordan, PA and Tunisia (Dimova, Elder and Stephan, 2016[32]).[8]

The societal dimension of fragility is also exacerbated by low levels of social protection, for which public spending averages to barely 1% of GDP in the wider MENA region, against 20% in OECD countries (World Bank, 2018[33]). Low levels of social safety nets, along with low overall coverage and high informality are especially worrying factors in view of the present pandemic and economic shock it has precipitated (Box 12.2). The societal dimension of fragility affects both the economic dimension of fragility as well as political stability: popular mobilisations across the region point to the clear dissatisfaction with a lack of economic opportunities and socio-economic inclusion.

Box 12.2. Covid-19 is exacerbating the dimensions of fragility

Even in economies with relatively low rates of infection, lockdowns and other measures have had a range of socio-economic impacts (ACAPS, 2020[34]). The pandemic and resulting global recession have already exacerbated risks and weakened coping capacities, across the economic, environmental, and societal dimensions of fragility:

- Economic dimension: Extreme poverty will likely increase. According to the IMF's October estimates, the Gross Domestic Product (GDP) of the average fragile context will decline by 4% in 2020 (IMF, 2020[35]). Economic contractions in some MENA countries could be substantially greater, with some estimates suggesting GDP growth to contract by 19-25% in Lebanon and by 40-67% in Libya, though estimates are subject to high degrees of uncertainty (World Bank, 2020[36]).
- Societal dimension: Women and children will feel these effects disproportionately. Before the pandemic, the extreme poverty rate for women was expected to decline by 2.7% between 2019 and 2021. However, estimates now suggest a 9.4% increase following the pandemic (UN Women, 2020[3]). School closures left 384.5 million children – in mid-July – out of school, and many of these children are unlikely to return (UNESCO, 2020[37]; UNDP, 2020[4]).
- Environmental dimension: Food insecurity is likely to rise. Recent estimates suggest that 83-132 million people globally could fall into chronic hunger by the end of the year (FAO, 2020[38]). For example, in July, approx. 9.6 million people were experiencing crisis or worse levels of food insecurity in Sudan, more than at any time in Sudan's history (IPC, 2020[39]). At the end of October, one in five children under five years old in the southern parts of Yemen are acutely malnourished, which is the highest ever recorded and reflects a confluence of violent conflict, economic decline, funding shortfalls in food assistance, and Covid-19's impact (FAO, UNICEF, and WFP, 2020[40]).

Lockdowns and other restrictions on movement also impact the political and security dimensions of fragility. For example, there is the risk that Covid-19 measures could violate democratic norms and standards for emergency measures, which may lead to democratic backsliding. (Edgell et al., 2020[5]).

The economic dimension of fragility

The economic dimension of fragility comprises an economy's vulnerability to shocks and its capacities to address them. Indicators of the economic dimension of fragility include GDP growth, debt, regulatory effectiveness, resource dependence, economic remoteness and labour market measures. High economic fragility negatively affects households' ability to exit poverty and improve their socio-economic conditions. Economic fragility is closely associated with social and political challenges.

Since 2011, the greater Middle East region has been characterised by stagnating growth. The concurrent impact of the Covid-19 pandemic and oil price shocks has dramatically worsened macroeconomic outlooks, with an average GDP contraction of 5.3% projected for 2020 across the focus economies, except for Libya and Lebanon, which are expected to experience a particularly dramatic downturn in GDP growth, by -40% and 19% respectively in 2020, due to aggravated political, social and security dynamics, though forecasts are subject to high degrees of uncertainty (World Bank, 2020[36]). Current account and fiscal balances also suffered from a steep decline in both oil-importers and oil-exporters in 2020, and they are expected to remain negative in 2021 (IMF, 2020[35]).

While all of the focus economies have long faced high debt levels, the current economic contraction represents a major threat to the debt sustainability of those focus economies with particularly high debt levels. This is the case for Lebanon – which in March 2020 defaulted on the payment of a USD 1.2 billion in Eurobonds – and to a lesser extent for Jordan, whose credit rating was revised from stable to negative (FitchRatings, 2020[41]).

More generally, widening deficits will constrain the ability of governments to implement measures in support of public health and local economies, at a time when sources of private financing, including FDI and household remittances are falling globally. For countries like Algeria and Libya, resource dependence contributes to economic fragility by weighing on other issues present across the region like inflation rate fluctuations, exchange rate weakening and constrained public revenues. High dependence on oil and gas revenues contribute to creating rentier regimes, low economic complexity, lagging productivity, and limit economic diversification and innovation (Malik, 2017[42]).

Foreign aid can, for some countries, serve as an additional financial buffer but for PA, Lebanon and Jordan, aid dependence carries the risk of exposure in the event of cuts in foreign assistance. Low regulatory quality – defined as governments' lack of capacity to formulate and implement sound policies to cope with economic fragility– also affects several MENA countries, notably Algeria, Libya and Egypt, as well as, to a lesser extent, Tunisia and Morocco (World Bank, 2019[43]). Finally, as noted above, unemployment rates in the region have remained high (ILOSTAT, 2020[29]).

The environmental dimension of fragility

The environmental dimension of fragility encompasses a country's vulnerability to climate and health risks affecting citizens' livelihoods, as well as the presence of the institutions that can mitigate such environmental and food insecurity risks. Environmental fragility can affect the distribution of resources, increase inequality as well as the risk of conflict.

All of the focus economies are familiar with the challenges of desertification, soil degradation and water scarcity both due to their geographical location and a variety of human factors that exacerbate these phenomena. Climate change is leading to increasing temperatures, decreased rainfall, rising sea levels and economic damage in the focus economies. For example, 96% of the territory of Tunisia is threatened by desertification, and the overall cost of environmental deterioration is estimated around 2.5% of the country's GDP (ITES, 2017[44]). These worrying developments threaten food security across the greater MENA region, where only 5% of the land area is arable and where total agricultural production is expected to decrease by 21% by the end of the century compared to 2000 (OECD/FAO, 2018[45]). The quality and quantity of groundwater, the most important source of water in the region, has been considerably deteriorating in recent years (Hamed et al., 2018[46]).

Demographic factors, urbanisation and industrial growth will keep increasing the demand for scarce water resources, potentially weighing on social and security dynamics. There are already some indications that the densely populated Nile delta and coastlines of Algeria and Morocco are high-risk areas for climate-induced forced displacement (IOM, 2015[47]). Waste management is also a widespread issue, worsening land, water and air pollution and the associated health risks for the local population. The series of protests that took place in Lebanon in 2015 over the government's failure to dispose over 20 000 tons of garbage in and around the capital is just one example of how these environmental and health issues can feed and trigger social discontent and instability.

The security dimension of fragility

The security dimension of fragility encompasses a country's vulnerability to violence, crime and conflict, as well as the presence of institutions to prevent and mitigate it. The security dimension of fragility can cause societal and economic disruption, as well as damage to infrastructure and supply chains, which can be particularly problematic for investors. Insecurity can erode cohesion and social capital, cause mass displacement, and is a human and personal tragedy for millions of people globally.

The greater MENA region, excluding high income countries, exhibits the highest level of security fragility among all regions of the world, by significant margin (OECD, 2020[2]). Exposure to conflict in MENA has increased from 6% in 2007 to 19.4% in 2017, with one in five people now living in close proximity to conflict (Corral et al., 2020[48]). The 2011 uprisings led to conflicts and inter-communal violence taking an incalculable toll in Syria, Yemen, Libya and Iraq.

Some of the focus economies have been significantly affected by these security developments. Conflicts have severed trade ties, decelerated private investment and strongly affected the tourism sector. For example, studies estimate that the Libyan crisis was responsible for 24% of the deceleration of economic growth of Tunisia between 2011 and 2015 (ESCWA, 2017[49]). Lebanon, Jordan, Egypt and Tunisia have also experienced considerable inflows of forcibly displaced populations from Syria and Libya. Transnational terrorism, moreover, continues to embody a concrete threat for most of the focus economies, albeit to different degrees, forcing governments to channel public expenditures into the national security apparatus and posing a security risk to businesses, deterring investors or requiring them to incur the cost of private security. Across the region, territorial disputes represent a source of tension and instability, notably in the case of the PA and Lebanon, as well as, to a different degree, Morocco. Finally, illicit cross-border trade and smuggling of arms, drugs, oil and humans from the Sahel region into Algeria, Morocco and Libya, caused by limited or weaker state capacity in the southern regions, has historically fuelled transnational crime networks and armed clashes (Ralston, 2014[50]).

Policy considerations to improve investment outcomes in the face of fragility

Despite the challenges outlined above, FDI can and does take place in the face of fragility, and can help address some of the underlying drivers of fragility by providing necessary sources of financing and contributing to inclusive and sustainable economic and social development. The impact of FDI depend on the level and nature of fragility, and the level of conflict. Conflicts deter investment, but post-conflict situations where reconstruction is needed can attract investors.

While more research is needed on how policymakers can integrate fragility analysis into investment policy, evidence from the region and beyond provides useful policy considerations to attract FDI and enhance its impact on the dimensions of fragility. Governments could consider adopting co-ordinated national strategies and measures alongside development partners to address fragility's impact on FDI; promoting risk mitigation measures and tools; and developing tailored investment promotion mechanisms. Implementation of these policies would vary among MENA focus economies as fragility affects them in different ways, to different degrees.

Enhancing the investment environment in a fragility context

Towards a holistic approach to investment, resilience and inclusive development

The complex interaction between fragility and investment underscores that inclusive development and quality investment attraction are complementary. OECD (2019[51]) has measured the extent to which FDI can affect specific aspects of sustainable development, pointing to a broad positive impact on economic and environmental sustainability. Although further work is needed to fully understand FDI's contribution to advancing SDGs, the institutional and policy context are pivotal in determining its eventual positive or negative economic, social and environmental impacts (*ibid.*). These findings suggest the adoption of holistic approaches to investment, resilience and inclusive development, where FDI is assessed against the wider framework of a country's policy priorities and long-term development vision. In some of the more fragile contexts, this means that improving framework conditions needs to keep pace with more direct actions to increase FDI.

National development strategies can hence be a useful tool to promote economic growth and attract investment, while integrating vulnerability considerations and strengthening societal resilience. For example, efforts to increase skills of youth, women and refugees can improve the enabling environment for FDI (Purfield et al., 2018[52]). The region is progressively integrating social objectives in its strategies: e.g., Egypt's Vision 2030 measures the achievement of sustainable inclusive growth based on an increased female labour force participation, while the Jordan National Vision and Strategy for 2025 ties together regulatory reforms of SME policy, training and rehabilitation programmes for women and youth employment. However, results on these objectives have been mixed and a renewed, long-term commitment to implement inclusiveness objectives is needed.

Laying the institutional and legal bases for a sound investment framework

In the most fragile contexts of the region, it is challenging to undertake investment climate reforms, especially when the priorities are on enhancing overall governance or de-escalating conflict (e.g. the Libyan Political Dialogue Forum). Limited state capacity and room for policy manoeuver may require careful prioritisation of specific measures that carry the largest benefits. As economies move out of conflict and unrest, additional steps can be taken towards institutional and legal reforms, serving as the basis for a future investment framework. The OECD-Iraq project provides some lessons on the importance of taking a tailored, flexible, and conflict-sensitive approach to such reforms (Box 12.3).

Box 12.3. Promoting investment in a fragile context: The OECD Iraq Project

Between 2007 and 2016, the OECD supported the government of Iraq in improving its investment climate. Tangible outcomes included: the amendment of the 2006 Investment Law; policy advice and capacity building on arbitration law and bilateral investment agreements; training of national and provincial investment commissions in developing and presenting investment marketing material, handling investor inquiries, and formulating investment opportunities. It also represented a unique and independent platform for public-private dialogue and allowed for the participation of high-level Iraqi policy-makers in the regional networks of the MENA-OECD Competitiveness Programme.

The Project had to react and adapt to the realities of a fragile and conflict-affected environment, with high levels of violence and insecurity, a deep sense of mistrust between the various ethnic, religious and political factions of the country, the surge of the so-called "Islamic State" and the collapse of oil prices in 2014-15.

Based on the OECD Principles for Good International Engagement in Fragile States and Situations, the Project identified five key lessons:

- Do no harm: The project ensured that the selection and involvement of Iraqi stakeholders in the project activities did not add to or exacerbate existing political tensions. The project conducted a Conflict Sensitivity Analysis and a Stakeholder Analysis ensuring a wide and balanced representation of stakeholders and increasing acceptance, ownership and thus impact.
- Consistent monitoring and flexible approach: As political priorities often change fast in fragile environments, only a flexible project approach can respond adequately to stakeholders' demands and bring tailored solutions that produce results, while maintaining donors' support.

The Project conducted bi-annual impact assessments to determine the suitability of its policy advice. The donor (the Swedish International Development Cooperation Agency - Sida) showed a flexible implementation approach, often entailing a significant rebalancing, notably in view of the 2014 Islamic State offensive and its drastic implications.

- Integration of cross-cutting development perspectives: In a fragile context, economic policy reform is also likely to affect political, security and development objectives. Understanding local dynamics and sensitivities, the project analysed how its activities related to the cross-cutting development issues of poverty reduction, gender mainstreaming and conflict sensitivity.
- Frequent consultations and project ownership: In a fragile context often characterised by weak institutions, building strong relationships with individual stakeholders is as important as building relationships with institutions. The Project built relationships with key stakeholders and engage into an inclusive approach, strengthening sense of ownership, which translated into mutual trust and fruitful communication
- Public-private dialogue: PPD can be a powerful instrument for strengthening the quality of economic policy reforms and is considered particularly important in fragile and conflict-affected contexts, as it can improve transparency, quality and effectiveness of public policies and thus help build more resilient systems. The Project engaged non-public Iraqi stakeholders, as well as foreign firms investing in Iraq.

Source: (OECD, 2016[53])

Improving legal stability is one of the priorities governments should consider when faced by fragility. Fragility can increase the risk, or perceived risks, of expropriation, breach of contract and capital transfer restrictions, which in turn leads investors to withdrawing existing investments or cancelling planned investments (Kher & Chun, 2020). Reforms to support solid and transparent investment provisions on non-discrimination, fair compensation for expropriation, profit repatriation guarantees and property rights could help. When designing these measures, it is crucial that governments consider concrete steps needed to ensure their adequacy to recognised international standards.

International investment agreements (see Chapter 5) may provide an additional level of protection to foreign investors engaging in fragile contexts by granting protections alongside domestic laws.[9] At the same time, low implementation capacity, unforeseeable events, political and societal vulnerability and lack of inter-institutional co-ordination can potentially lead to involuntary breaches in fragile contexts (Kher and Chun, 2020[16]). In the midst of social and political turmoil in 2011, the region saw an increase of investor-state disputes, with Egypt and Libya being involved respectively in 24 and 16 known cases of international arbitration (UNCTAD, 2020[54]).

Effective implementation and enforcement of reforms aiming at improving legal stability in fragile contexts is equally relevant. This requires the establishment of bodies in charge of investment policy design and implementation, as well as co-ordination between them. For instance, a supporting institutional framework to deal with investors' disputes is still lacking in Libya, the PA and Lebanon (Chapter 5). Overall, in contexts where state monitoring and enforcement capacities are lacking and institutions are weak, investment policy remains scattered across several institutions and agencies. This can further raise the risk for inefficiency and inconsistencies.

Development actors can support private sector development and help improve the investment environment in fragile contexts

Development partners can help improve the investment environment in fragile contexts, both through technical cooperation, for instance on how to better manage and prevent investment disputes (e.g. the

World Bank Investor Grievance Management Mechanism), and financial pledges to support private sector development. Private sector development as an enabler of political, societal and economic resilience has been central to donor approaches in MENA. Various conferences (e.g., the 2016 London Syria conference, the 2017 and 2018 Brussels conferences for Syria and the region, and the 2018 Kuwait conference for Iraq, the 2020 Conference in support to the Lebanese people) resulted in financial pledges to support countries requiring post-conflict reconstruction assistance (Iraq and Syria) or facing large refugee inflows (Jordan) in the form of so-called "compacts" (Box 12.4).

More generally, development actors have been increasingly providing significant financial support to the most fragile contexts, which have limited capacity and funding. In recent years, financing for the most fragile contexts has reached record volumes: in 2018, bilateral donors spent USD 76 billion in the 57 most fragile contexts covered by the OECD fragility framework, the highest number ever recorded.

Box 12.4. Addressing the refugee crisis through the Jordan Compact

In 2016, the Government of Jordan, with the support of the international community, committed to improving the living conditions, prospects and resilience of Syrian refugees and Jordanian citizens and supporting the economy.

The three objectives of the Jordan Compact are: a) turning the refugee crisis into an opportunity to attract new investments, opening up to the EU market, and creating jobs for Jordanians and Syrian refugees; b) rebuilding the resilience of host communities by adequately financing; and c) supporting the Jordanian macroeconomic financing needs over the next three years, in the context of a new IMF programme.

The government introduced special work permits for Syrian refugees working in 18 new special economic zones (SEZs). Firms established and operating in these SEZs benefitted from concessional loans provided by the World Bank and preferential trade access to the EU if they sourced at least 15% of their workforce among Syrian refugees (EU Decision on relaxation of rules of origin). In parallel, the government committed to improve its investment climate to attract domestic and international investments through promotion, facilitation and reforms of business licensing and regulations.

Results, however, have been limited. As of February 2019, only 16 companies had applied for registration to export under the EU preferential scheme and 13 were approved. Collectively, these employed 280 Syrians – a figure that dwarfs the 300,000 working-age refugees registered in Jordan. Unattractive wages in SEZs and low levels of greenfield FDI have been pointed to as the main obstacles.

Nevertheless, this approach showed how displaced population can be seen as assets, rather than liabilities, and has been replicated in other contexts (i.e. Ethiopia). It also demonstrates an innovative example of how policies can be designed to strengthen societal resilience, while also providing new investment and market access opportunities.

Source: (Dettoni, 2019[55]); (Ali Slimane et al., 2020[56]); (World Bank, 2016[57]); (Government of Jordan, 2016[58]); (Barbelet, Hagen-Zanker and Mansour-Ille, 2018[59]).

Mitigating the risks that fragility poses for investors

Blended finance and risk transfer mechanisms

Though not replacing wider business climate reforms, a number of concrete and temporary instruments are available to insure investors against specific types of risk, in particular political risk. They include blended finance approaches and risk transfer mechanisms like export credit and political risk insurance. However, these tools are not a panacea. They are most effective alongside, rather than instead of, policy reforms (Basile and Neunuebel, 2019[60]). They require a case-to-case analysis that needs to integrate fragility considerations and appropriate safeguards and monitoring. Avoiding engaging government institutions, or focusing only on short-term "easy wins", could exacerbate fragility in the long run (Williams, Burke and Wille, 2014[61]).

The OECD defines blended finance as the strategic use of development finance to mobilise additional finance towards sustainable development in developing countries. Blended finance can take many forms, including the use of public guarantees, PPPs, debt instruments, equity investment, as well as innovative social-impact investment (Basile and Neunuebel, 2019[60]). OECD official statistics show that private finance mobilised by official donor interventions reached USD 48.4 billion globally in 2018, much of it concentrated in emerging markets (OECD, 2020[62]). Almost two thirds of these amounts were mobilised in economic infrastructure and financial services, mostly by guarantees, syndicated loans and direct investment in companies and special purpose vehicles (ibid.).

Blended finance can catalyse investment in fragile contexts by transferring some risks away from investors. In 2016, 15 of the largest development finance institutions (DFIs) invested a total of USD 1.3 billion in fragile contexts. IFC (2019[9]) accounted for one-third of this amount and committed to increase the share of its investments in fragile contexts and low-income countries to 40% by 2030. As for MIGA, 12% of its outstanding guarantee portfolio is in fragile contexts, accounting to USD 2.7 bn.

Interest in blended finance approaches has picked up in the last decade, including through dedicated funds and facilities. Based on recent data from the OECD's Blended Finance Funds and Facilities Survey – which includes 198 funds and facilities managed by both public and private organisations – has captured around USD 74.5 billion of assets under management globally. Of this, an estimated around 2.7 billion targets the focus economies, the majority (USD 1.5 billion) in Egypt (Dembele, Vilalta and Bangun, forthcoming[63]).

Development finance institutions (DFIs), development partners and export credit agencies (ECAs) can support investors through risk-mitigation instruments and financing. DFIs generally mitigate risks, real or perceived, of private investment undertaken at commercial or quasi-commercial terms (Miyamoto and Chiofalo, 2015[64]). Tools offered by DFIs include financial and technical support to private companies (e.g., project preparation services), including foreign investors, and mobilisation of private investment for activities with a developmental purpose. Instruments include long-term loans, equity capital, mezzanine finance and guarantees (both full and partial), as well as investment in local banks or on-lending to private companies (ibid.). The Islamic Development Bank Group (IsDBG) is a prominent example of DFI active in 57 shareholding economies in the wider MENA, including all focus economies. The Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), within the IsDBG, offers political risk insurance (PRI) covering issues such as transfer and convertibility, expropriation, and war and civil disturbance. With the objective of facilitating FDI, ICIEC's country risk insurance covers equity and non-equity investment under the condition that the investment is Sharia-acceptable.

Development partners can also offer a variety of risk-transferring tools to help mobilise private investment in fragile contexts. MIGA's Conflict-Affected and Fragile Economies Facility (CAFEF), for example, issues guarantees to eligible projects that provide an initial loss layer insurance. These cover loans, equity investments and future earnings against currency inconvertibility and transfer restriction, expropriation, breach of contract, war and civil disturbance. In 2010, the IFC added fragility to its strategic priority areas and established a Fragile and Conflict-affected States Coordination Unit. In MENA, the IFC invests and provides advisory services to international private investors and public institutions through its Conflict Affected States in Africa Initiative. For example, Scatec Solar ASA, an independent solar power producer listed on the Oslo Stock Exchange, has secured guarantees with MIGA in March 2020 to cover its equity investment in six Egyptian solar power plants. The guarantees cover 90% of investments by Scatec Solar for up to 15 years against the risks of transfer restrictions and convertibility.

ECAs are financial institutions, either private or government-sponsored, that support domestic exporters through short-term trade financing in the form of credit, insurance and guarantees or project-specific long-term financing (e.g. in infrastructure). ECA support among OECD countries is co-ordinated through the Arrangement on Officially Supported Exports Credit and the Working Party on Export Credits and Credit Guarantees, which serves as an important framework for the setting of minimum interest rates, risk fees and maximum repayment terms, as well as environmental and integrity standards.

Overall, despite of the wide variety of options available, penetration of risk mitigation mechanisms in the region seems to be relatively low and could be strengthened. A recent report of the US International Development Finance Corporation (DFC) highlights that, despite the high risk for foreign companies in some MENA contexts, tools like political risk insurance remain underexploited (OPIC, 2019[65]). According to the report, when asked for the reasons why they did not make use of political risk insurance, investors responded that they either did not believe the level of risk warranted for the adoption of such instruments, that the costs of coverage were too high or that they were simply unaware of this possibility (ibid.), suggesting that additional promotion and facilitation of risk mitigation options could, to some degree, bring benefits.

Promoting linkages between foreign firms and domestic businesses

Strengthening links between international investors and domestic businesses can also play a key role in mitigating potential risks for investors. Linkages with local businesses in domestic supply chains can mitigate operational risks thanks to their knowledge of the local context and their higher risk tolerance (World Bank, 2018[66]). Joint ventures or alliances with local companies are the most common strategies chosen by international investors to mitigate political risks in emerging markets (MIGA, 2014[67]). However, this can be particularly difficult to achieve for investors in fragile contexts due to insecurity, market fragmentation, a lack of sectoral linkages and under-developed business clusters (ibid.). IPAs can play a pivotal role in developing tailored strategies or programmes in this respect, focusing first and foremost on strategic and attractive sectors (Chapter 8).

Linkages between multinational enterprises and local firms, particularly SMEs, also increase employment and training opportunities, development of human capital, as well as knowledge and technology transfers. In the case of Libya, the OECD (2016[68]) has analysed the pivotal role that SMEs can play in the reconstruction of the country, reviewing the current national framework and identifying recommendations that can contribute to pave the way for post-conflict recovery once the situation has stabilised.

Promoting integrity and responsible business conduct

Governance risks, in particular corruption, represent a major financial, legal and reputational risk for international investors (Chapter 11). Corruption, as well as poor state capacity and weak monitoring and enforcement mechanisms, reduce FDI inflows (Wei, 2000[18]). Studies specific to the region highlight that integrity improves the positive impact of FDI on economic development (Hakimi and Hamdi, 2017[69]). On the investors' side, responsible business practices can reinforce the investment climate in fragile contexts, through accountable behaviours and increased transparency, especially in sensitive sectors such financial and extractives sectors (Chapter 10). In MENA focus economies, no IPA with the exception of the Moroccan one prioritises investors with a good RBC track record (Chapter 6).

Developing investment promotion strategies tailored to fragility

Sectoral focus

Adopting a sectoral focus for FDI promotion in fragile contexts can help achieve two concurrent objectives: identifying and exploiting an economy's comparative advantages, and supporting specific sectors in line with development, reconstruction and resilience strategies, as well as people and business needs. For example, research suggests that FDI in sectors like infrastructure, energy, agribusiness, retail and social services can contribute to peace consolidation and often offers high returns (WEF, 2016[8]). In post-conflict environments, evidence shows that, together with services, construction is the fastest-growing sector (World Bank, 2018[66]). Promoting FDI in infrastructure can further strengthen and support post-conflict or disaster rebuilding efforts, while also enhancing connectivity with regional and global markets (Box 12.5). For example, plans for the reconstruction of the Port of Beirut, together with a reform of the Lebanon port sector, is an opportunity to stimulate trade and economic growth.

As previously observed, most FDI in the region is channelled into capital-intensive sectors, which have contributed little to productivity and job creation, key to sustainable economic growth. Between 2003 and 2019 the majority of greenfield investment in the focus economies went to real estate and construction projects (35%) and extractive industries (26%). Investment in manufacturing has increased in recent years, but the sector attracts a relatively small amount of overall investment in the focus economies, and the service sector even less. Only 5% of greenfield FDI in Libya has gone to manufacturing since 2003 (Chapter 2).

Box 12.5. Infrastructure to attract FDI while boosting diversification and connectivity

Fragility poses additional strains on the existing infrastructure in a number of focus economies in the region and makes it even more difficult to attract much-needed investment to increase connectivity with the global economy (Chapter 9). Poor infrastructure, particularly prolonged power outages and water supply shortages, are severe challenges faced by businesses in fragile contexts (IFC, 2019[9]). For example, firms reported losses due to electrical outages over one firth of their annual sales in PA (*ibid.*). In Libya, the civil war led to a degradation in the availability of infrastructure services such as water for the population, while in Lebanon, electricity is the second biggest obstacle for firms and the quality of infrastructure is among the poorest in the world (EBRD, EIB, & World Bank, 2016[70]).

Infrastructure projects, whether in the transportation, energy, water or telecommunications sectors, are central in a post-crisis context to address reconstruction and rehabilitation needs, provide basic services to refugees and support the resilience of host communities through economic development and job creation (OECD, 2018[71]; Rubaba et al., 2015[72]). They are also instrumental in ensuring the continuity and viability of trade routes connecting countries to regional and global markets.

In Egypt, for example, the government initiated a number of mega-projects to increase economic resilience through better participation in global value chains. It invested over USD 335 billion, across real estate, transport and energy infrastructure (Flanders Investment & Trade, 2018[73]). Egypt has also doubled its level of electricity generation capacity over the last six years and is now in a situation of power surplus (Magdy, 2020[74]). In Jordan, the influx of over 1.3 million refugees from Syria put significant pressure on its infrastructure, particularly water supply. The 2025 National Vision and Strategy recognises the key role of infrastructure to achieve economic transformation and resilience based on export development (Harake, 2019[75]). Jordan is seeking to become a regional logistics hub, notably for electricity and transport networks.

Governments and IPAs in the region are aware of the need for diversifying the economy and prioritising investment in more productive and labour-intensive sectors. All but one IPA in the focus economies prioritise investments in certain sectors (Chapter 6). For example, the Palestinian National Policy Agenda includes the objective to attract FDI in the priority sectors of construction, tourism, agriculture and ICT. An assessment of the economy's competitiveness, in line with the needs to address fragility, is a relevant initial strategy to target specific sectors or projects (Whyte and Griffin, 2014[76]).

Targeting investors

Investment promotion tailored to very fragile countries may be aided by a strategy targeting specific investors that are more likely to engage in such contexts. This could include investors with prior experience in fragile contexts, with the capacity to deal with potential associated risks, or investors that were present before a period of instability, who may be willing to re-engage (Whyte and Griffin, 2014[76]). Investors from neighbouring countries or from diaspora communities are also likely to have good knowledge and understanding of the national context, can build and use their networks, and potentially take advantage of underutilised value chains. They may operate at a smaller scale but build stronger business linkages with the local economy. Preliminary evidence suggests, for example, that in fragile contexts, investors are more likely to come from other developing countries than are investors into more stable developed countries (Basile and Neunuebel, 2019[60]).

Targeting regions

Identifying geographical areas with relatively higher levels of security where investors can safely operate in very fragile contexts has been identified as a potentially useful, if temporary, strategy (World Bank, 2018[66]). Special Economic Zones (SEZs), free zones and industrial clusters are increasingly common in many developing economies. They can help to partly neutralise the effects of an otherwise less favourable business climate by offering differentiated treatment or services to investors, such as through tax or administrative incentives or better infrastructure than in the rest of the country. The creation of zones is often a reflection of the need to offset a negative impact of stringent import protection on trade or challenges in accessing secured land under the inland regime (OECD, 2020[77]).

However, impact of zone-based strategies in fragile contexts has been mixed. While zones can attract FDI and help boost exports, their expected benefits in terms of economic development are not necessarily positive or automatic but are greatly contingent on the local business environment. More problematic, they may be impeding fair competition between firms inside and outside of zones, and risk creating economic enclaves. They also bear a certain cost on government revenues as the incentives, particularly corporate income tax holidays, granted to firms reduce the fiscal base. Further analysis on the impact of SEZs in MENA fragile contexts on investment attraction and enterprise activities (e.g. Tripoli Special Economic Zone in Lebanon or the Misrata Free Zone in Libya) would allow to build lessons and good practices.

In some economies, involving subnational IPAs in promotion and facilitation mechanisms may also be useful to channel investment to specific regions (see chapter 6). In principle, IPAs may contribute to ease operations at the sub-regional level in large countries, attract investment to safer areas in conflict-affected economies, balance economic development across the territory, and facilitate dialogue with local communities. For example, Iraq built a network of 15 Provincial Investment Commissions with some being proactive in attracting investment (OECD, 2016[53]).[10] However, caution is once again necessary. Potentially low capacities of local institutions and lack of co-ordination with the central level may complicate administrative procedures and increase transaction costs and corruption risks.

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Notes

[1] Published every two years, the OECD's States of Fragility report analyses 175 economies using data across the five dimensions of fragility, including all of the focus economies. The 57 profiled in the States of Fragility report are the most fragile globally. For the latest report, please see (OECD, 2020[2]).

[2] This analysis excludes the high-income economies of the MENA region. The list of countries included in the MENA region follows the World Bank Group classifications, available here: World Bank Country and Lending Groups – World Bank Data Help Desk.

[3] The framework captures the diversity of contexts affected by fragility. Additional information on each dimension and what it measures, as well as the methodology for States of Fragility, is available on the States of Fragility platform at http://www3.compareyourcountry.org/states-of-fragility/report/0/.

[4] The World Bank Group analyses fragility differently to the OECD, focused on countries with high levels of institutional and social fragility, and countries affected by violent conflict, based on the number of conflict-related deaths relative to the population. Further information can be found here: Classification of Fragile and Conflict-Affected Situations (worldbank.org)

[5] Political risk refers to the risk that government decisions, events or conditions will significantly affect the profitability of an investment or economic decision. Political risks can include expropriation of assets, breach of contract, currency inconvertibility and transfer restrictions, regulatory changes, terrorism, war, civil disturbance, and non-honouring of sovereign financial obligations. Some types of political risk can be covered by political risk insurance instruments and guarantees. For a fuller discussion, see Kher and Chun (2020[16]) at https://openknowledge.worldbank.org/handle/10986/34380.

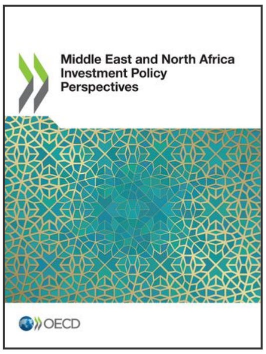
[6] See Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas, available here: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0821.

[7] Here and throughout the OECD fragility framework analysis, the MENA region excludes high income countries. The list of countries included in the MENA region follows the World Bank Group classifications, available here: World Bank Country and Lending Groups – World Bank Data Help Desk.

[8] Values for latest data available: Egypt (2014), Jordan (2015), Lebanon (2015), PA (2015), Tunisia (2015).

[9] However, evidence of impact of investment agreements on increased FDI inflows has been questioned in recent years (Pohl, 2018[78]).

[10] The National Investment Commission (NIC) coordinates 15 PICs in central and southern Iraq which function as regional IPAs. They are independent bodies, responsible of their province. The Investment Law grants the PICs with the power to issue investment licences, plan projects, promote the provincial investment environment, and open branches within their jurisdictions.



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