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The Arab Spring: How soon will foreign investors return?

by
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The events of the Arab Spring have dramatically increased the risk perceptions of foreign investors. In directly affected countries, these events led to disruptions in economic activity including plummeting tourism and foreign direct investment (FDI) flows, all of which negatively impacted economic growth. While the economic impact was uneven across the Middle East and North Africa (MENA) region, for the region's developing countries the growth rate assumption underpinning survey analysis in the Multilateral Investment Guarantee Agency's (MIGA's) World Investment and Political Risk Report for 2011 was 1.7%.[1] How much will these developments affect future FDI?

The financial crisis in 2008 led to declines in aggregate FDI flows into MENA. As events unfolded in 2011, FDI flows into MENA plummeted further in the directly affected countries; for example, in the first quarter of 2011, FDI inflows turned negative in both Egypt and Tunisia, which were two of the most affected countries.[2] The World Bank has forecasted FDI flows into MENA to decline in 2012, but to grow again in 2013. Over the medium and longer term, the region's economic and demographic factors will continue to

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[1] The developing economies in MENA are Algeria, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, West Bank and Gaza, and Yemen. MIGA.

[2] Central Bank of Egypt, "Monthly statistical bulletin," August 2011; Central Bank of Tunisia, "Development of main flows and balance of external payments receipts," available at: http://www.bct.gov.tn/bct/siteprod/english/indicateurs/paiements.jsp#qqind.

attract market-seeking foreign investors, more so under conditions of improved governance.

The findings of a foreign investor survey jointly undertaken in 2011 by the World Bank's MIGA and the Economist Intelligence Unit[3] found that the turmoil did have a significant impact on corporate investors' investment intentions concerning MENA: a quarter of investors put their plans on hold, while others reconsidered (18%), canceled (11%) or withdrew investments (6%). Only just below a third did not alter their investment plans (see the supporting data below). Despite heterogeneity among the different countries in MENA, on balance, the turmoil has stressed existing investments and dampened plans for expansions and new investments. While there are differences between investors in extractive industries, these differences do not affect the overall results from a representative sample of investors worldwide. Thus, the findings are probably less negative than they would be if the oil sector was excluded.[4]

Some investors in the countries directly affected by the civil disturbances, especially investors in the energy and service sectors, have reported suspending operations.[5] All of this has been amplified by the worsening state of domestic economies, as current account deficits and budget deficits have widened, private capital flows have weakened, inflation has risen, and production and investment have declined. Political violence -- especially civil disturbance and to a lesser extent war and terrorism -- ranked particularly high as the risk of most concern as did governments' abilities to honor their sovereign financial obligations.

The survey found greater confidence from multinational enterprises (MNEs) investing in stable democracies relative to stable authoritarian regimes. This pattern has also emerged in the region: just over half of the firms surveyed would invest in MENA, assuming that there is at least a year of stability under a democratic government. Nearly half of the firms in the survey said they would decrease investments should there be significant and persistent instability, even in the presence of democracy. Only 8% of firms would increase their investments under such circumstances. The worst-case scenario would be a period of prolonged and significant instability, where nearly half of the firms surveyed would substantially decrease investments. In the event of a non-democratic regime that nevertheless succeeds in stabilizing the country for at least a year, 44% of the firms surveyed claimed that they would not change their plans for investment, essentially adopting a "wait and see" approach. This lesson is also supported by evidence from the private political risk insurance market, which stressed the difficulty in selling coverage in seemingly stable authoritarian regimes, but saw the demand for coverage in such countries (both in MENA and worldwide) rise as a result of the events in MENA.

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[3] The survey covered a representative sample of 316 senior executives from MNEs investing in developing countries. The survey was conducted in June-August of 2011. Therefore, the particular questions on MENA involved a self-selection of firms active or intending to invest in MENA; however, these were compared with the global questionnaire for consistency of overall findings.

[4] Due to sampling size of the MENA specific investors, the survey is not able to clearly draw this distinction.

[5] "Arab Spring cleaning: What regional turmoil has meant for Western investment," *Business Law Currents*, August 25, 2011.

The findings of the survey provide evidence of both pitfalls and possibilities arising from the Arab Spring. Investors will return fairly quickly once stability returns given the vast opportunities in the region. Most investors would prefer this stability to be under a democratic regime. Thus there is long-run optimism that, if political transitions in the region are democratic and coupled with political stability, the Arab Spring could increase FDI and help contribute to economic development in the region.

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The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Ms. Lisa Sachs, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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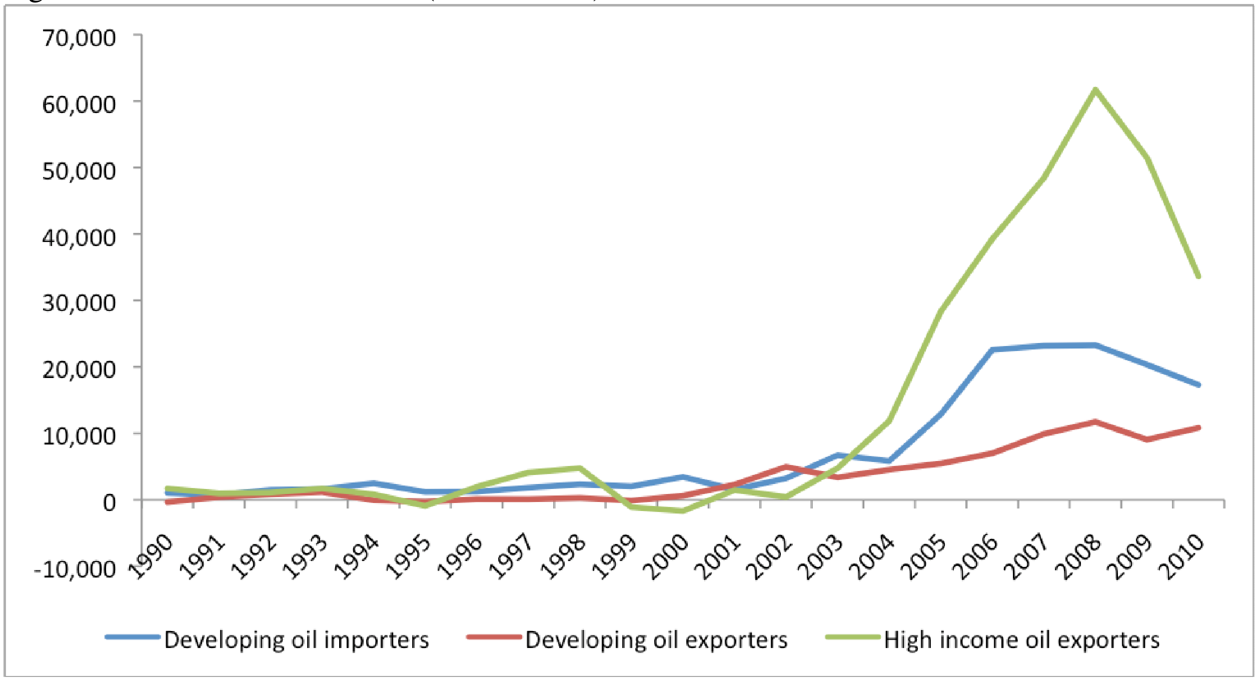
Appendix

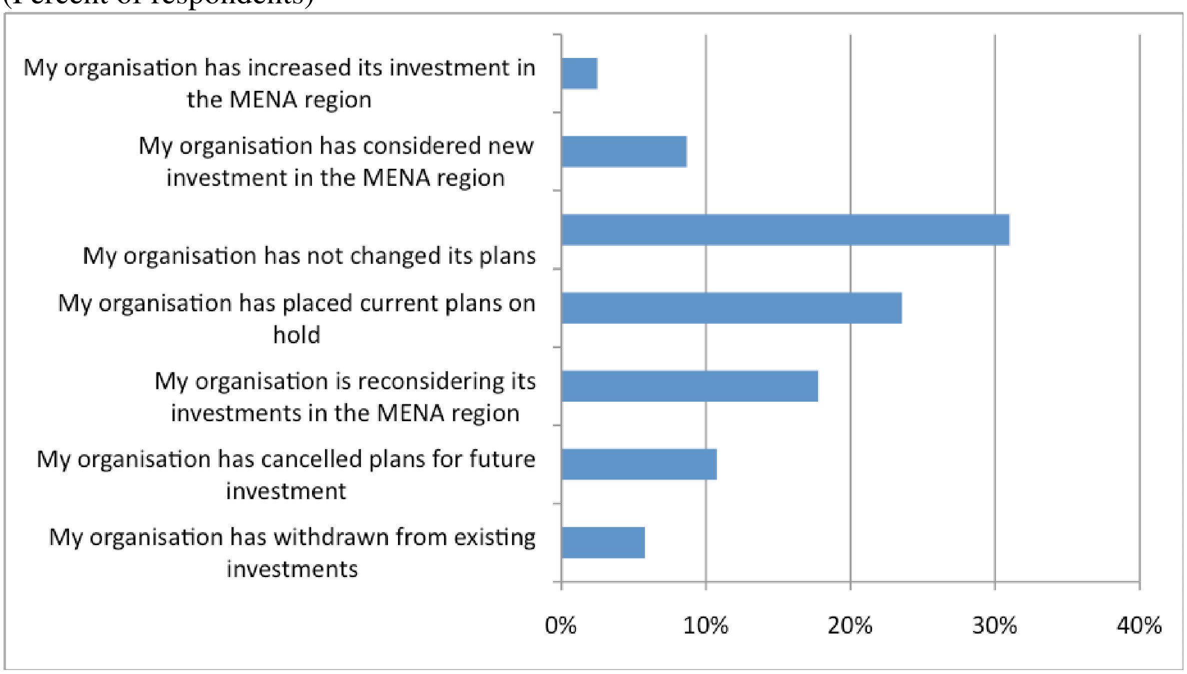
Figure 1. FDI flows into MENA (US$ million)



Source: World Bank Data Catalogue, retrieved in October 2011

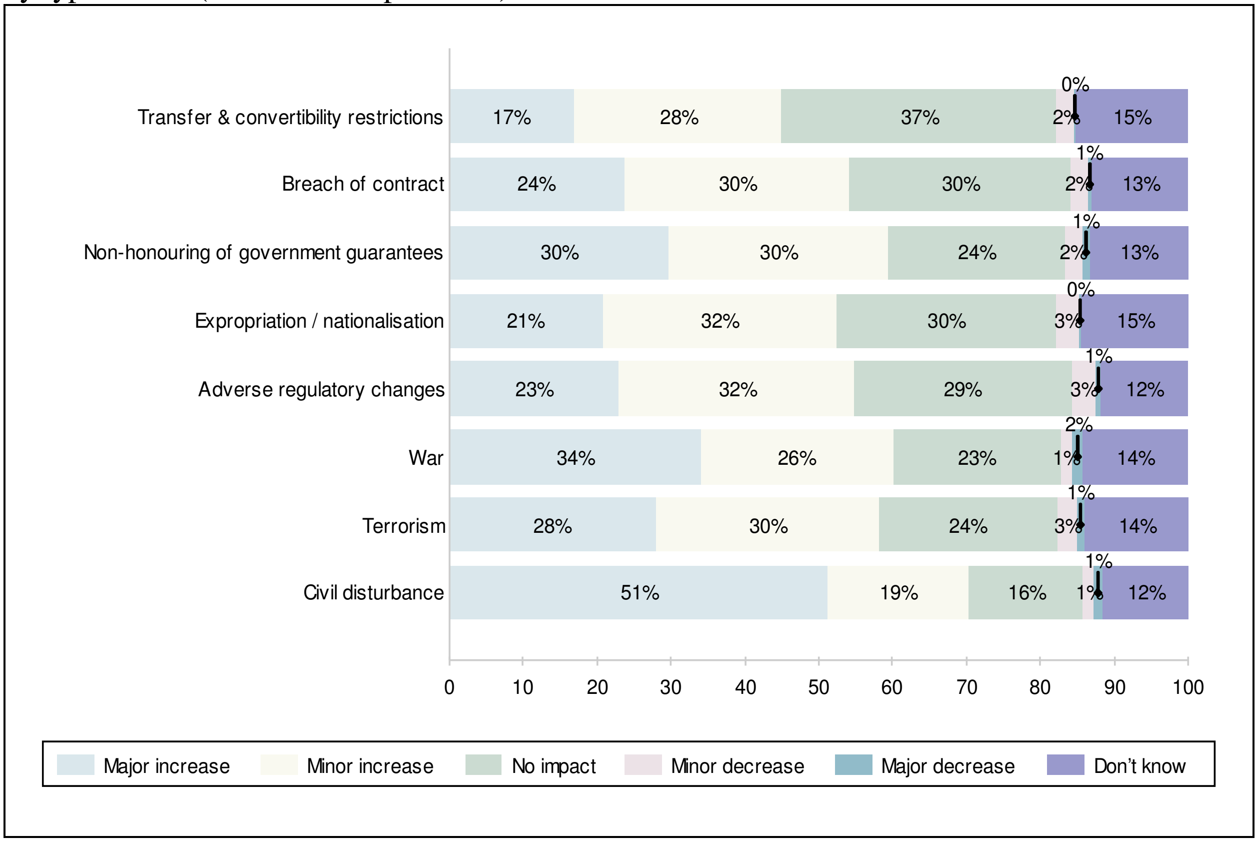
Note: Developing oil importers: Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, West Bank and Gaza
Developing oil exporters: Algeria, Iran, Iraq, Libya, Yemen
High income oil exporters: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, Oman, UAE

Figure 2. Effect of the recent turmoil in MENA on investment plans in the region (Percent of respondents)



Source: MIGA, World Investment and Political Risk 2011 (World Bank, Washington DC).

Figure 3. Effect of the recent turmoil in MENA on political risk perceptions in the region, by type of risk (Percent of respondents)



Source: MIGA, World Investment and Political Risk 2011 (World Bank, Washington DC).