Do Institutions Matter for FDI?

A comparative analysis for the MENA Countries

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In the last decade, the countries of Middle East and North Africa (MENA) passed through huge macroeconomic and institutional reforms to increase international opening, improve stability and encourage the development of the private sector.

The European-Mediterranean Partnership agreement, and the start of liberalisation processes had a positive impact on the international commercial integration of MENA regions. Nevertheless, high constraints duties on import and non-tariff barriers (such as administrative, quality standards and systematic technical controls) that still remain, make the region one of the most protected to the world.

Reform strategies – implemented, for instance, in Israel, Egypt, Morocco, Algeria and Jordan, increased the macroeconomic stability of the region. The improvement of the economic and institutional systems increased the pace of FDI inflows towards MENA. Within such a framework studies point-out as market-oriented reforms appears still insufficient to increase the degree of competitiveness of this area, particularly in comparison with other emergent economies as those of the East Asia or Latin America.

The decisions of investment of multinational enterprises are influenced by several factors. At the macroeconomic level, empirical studies emphasize determinants as the economic and political stability, the degree of international opening and the efficiency of the institutional system (included business climate). The influence of these variable results particularly important in the developing and emergent economies, or in those in transition toward the market system, in particular for greenfield investments.

Despite a comparatively lower labour cost and the relative integration with the countries of the north of the Mediterranean, MENA countries don't seem able to

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offer significant attraction factors for multinational enterprises. Several studies show as the disincentives to the FDI are correlated, mainly, to the macroeconomic framework of the region, delays in carrying out reforms, low quality of the institutional system, as well as specific risks of political and social nature of some countries.

In this paper we examine the role of the institutional system in the capacity of MENA countries to attract FDI. The analysis considers a series of synthetic indicators able to provide a snapshot of institutional and legal framework of MENA Countries. Using the Kaufmann, Kraay and Mastruzzi (2005) governance indicators, we examine the role of institutions on FDI trough a regression analysis. Our analysis show as institutions play an important role in the relative performances of countries in attracting FDI. At last, data on institutional quality and business climate show the relative disvantages of MENA. Our paper suggests as MENA countries require deep institutional reforms in order to improve the attractiveness in terms of FDI.