Challenges to Private Investment in the Middle East North Africa Region

…and what the World Bank is doing

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Regional Stability an overriding concern in MENA: region has had a history of volatility – which has dampened investment and tourism, and therefore job creation

- **Conflicts:**
  Lebanon, Israeli-Palestinian conflict, Iran-Iraq war, Algeria, Gulf war
- **Embargos**
  Libya, Iraq
- **Uncertainty**
  September 11 aftermath, current Iraq uncertainty
Three Dimensions of a Good Investment Climate

- *Macroeconomic stability and openness:* stable and transparent fiscal accounts, low inflation and trade barriers
- *Good governance and strong institutions:* regulatory institutions that promote competition, support efficient resource allocation, protect property rights, and are implemented without harassment and corruption. Strong legal and financial institutions are key
- *Adequate infrastructure:* quality and quantity of power, communications, water, transport, financial infrastructure, skills and technology

*Improvements generate self-reinforcing change*
SMEs and the investment climate

- SMEs bring flexibility, observability and “disruptive innovations”
- SMEs suffer most from a bad investment climate
- Symptoms are evident in “missing middle” of firms (for different reasons, e.g. transition)
- Encouraging SMEs
  - *From micro to small and medium-sized*; informal to formal; removing obstacles to growth; SME financing (e.g., IFC SME financing)
  - *From large to medium-sized* in transition; restructuring dinosaurs, spin-offs
  - *Avoid perverse incentives* for small firms to remain small and large firms to fragment, e.g., Russian tax incentives for SMEs
Investment climate makes a big difference

Growth of fixed assets (%), 1999

Uttar Pradesh: -0.7%
West Bengal: 1.8%
Kerala: 3.0%
Delhi: 2.1%
Punjab: -3.1%
Tamil Nadu: 6.0%
Karnataka: 6.9%
Andhra Pradesh: 5.6%
Gujarat: 7.5%
Maharashtra: 8.1%

Note: Investment rate is calculated from firm level data and is the rate of growth of fixed assets.
Source: World Bank 2002, Improving the Investment Climate in India
Macroeconomic stability and openness

• Broad nominal macroeconomic stability in MENA— inflation, ER, budget deficits
• But large real volatility driven by: (i) terms of trade shocks, (ii) pro-cyclical fiscal policy, (iii) political and natural shocks, (iv) fixed nominal ERs
• Lagging integration and openness
Exports as a proportion of GDP, 2000
MNA versus the rest of the World

Total exports as a share of GDP (percent)

- MNA
- East Asia Pacific
- Europe & Central Asia
- High Income/OECD
- Latin America Caribbean
- South Asia
- Sub-Saharan Africa

Non-oil and Oil categories are indicated by different colors.
Ongoing work at the World Bank: Building an empirical understanding of micro aspects of the investment climate

• **Firm level surveys**
  – Large random samples; e.g., 1,200 in India, 1,500 in China
  – Standard firm information (sales, outputs, inputs, etc) and quantitative data on investment climate
  – Enables firm level understanding of how bottlenecks deter productivity and growth
  – By next year, investment climate surveys in 30 countries

• **Measuring regulations across 110 countries**
  – Surveys of experts and studies of institutions to generate comparable country level data on investment climate; e.g., the procedures, time and cost for business entry
International comparisons from firm surveys: infrastructure services

Electricity

<table>
<thead>
<tr>
<th>Country</th>
<th>Days Without</th>
<th>Own Generator</th>
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</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>18</td>
<td>13</td>
</tr>
<tr>
<td>Morocco</td>
<td>16 16</td>
<td>5 4</td>
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<tr>
<td>China</td>
<td>16 16</td>
<td>16 16</td>
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<tr>
<td>Algeria</td>
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<tr>
<td>Morocco</td>
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<td>39</td>
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<tr>
<td>China</td>
<td>33</td>
<td>61</td>
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<tr>
<td>India</td>
<td>84</td>
<td>61</td>
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</table>

Water

<table>
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<th>Country</th>
<th>Days Without</th>
<th>Own Well</th>
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<tbody>
<tr>
<td>Algeria</td>
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<td>43</td>
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<tr>
<td>Morocco</td>
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<td>28</td>
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<tr>
<td>China</td>
<td>17 3 3</td>
<td>43</td>
</tr>
<tr>
<td>India</td>
<td>65</td>
<td>43</td>
</tr>
</tbody>
</table>

Note: S = Small firm; L = Large firm.
Source: World Bank Investment Climate Surveys
MNA lagging on Knowledge Infrastructure

- 5% world population; 0.7% Internet users: lowest score in the world
- R&D about 1/5 of industrialized countries
- 1998 book production
  - UK 110,965
  - Poland 19,192
  - Iran 12,020
  - Turkey 9,313
  - Egypt 1,410
  - Morocco 894
Good governance and regulatory institutions

- Includes the institutions for
  - *Competition*: entry, exit, state ownership
  - *Resource allocation*: tax, labor, capital (financial inst.)
  - *Property rights and enforcement*: rule of law, courts
  - *Public interest*: environment, health, safety
Time tied up with bureaucracy discourages foreign investment

Note: Partial correlations controlling for market size, human capital, macroeconomic stability.
Investors are becoming more concerned about regulatory quality.

Share of all FDI to developing countries, 1994-2001

Bureaucratic entry procedures and contract enforcement are costly.

Note: Partial correlations controlled for per capita income
Barriers to entry and exit allow inefficient firms to stay in the market.

Time to clear imports in Algeria and Morocco

<table>
<thead>
<tr>
<th>Country</th>
<th>Avg. # of days to clear customs (imports)</th>
<th>Longest # of days to clear customs (imports)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>24.1</td>
<td>84.2</td>
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<td>Morocco</td>
<td>2.7</td>
<td>5.4</td>
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<tr>
<td>India</td>
<td>10.6</td>
<td>21.2</td>
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<tr>
<td>China</td>
<td>7.9</td>
<td>12.5</td>
</tr>
</tbody>
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Business Registration and Contract Enforcement in Egypt

### Business Registration: January 2002

- **# Procedures**
  - Egypt: 13
  - MENA: 11
  - OECD: Not reported
  - Best Practice: 7
- **Days**
  - Egypt: 52
  - MENA: 60
  - OECD: 32
  - Best Practice: 2
- **Cost (% GNP per capita)**
  - Egypt: 61
  - MENA: 62
  - OECD: 0
  - Best Practice: 11

### Contract Enforcement: January 2002

- **# Procedures**
  - Egypt: 23
  - MENA: 20
  - OECD: 16
  - Best Practice: 10
- **Days**
  - Egypt: 17
  - MENA: 302
  - OECD: 202
  - Best Practice: 205
- **Bureacratic Complexity**
  - Egypt: 4.1
  - MENA: 3.8
  - OECD: 3.1
  - Best Practice: 0.73

Sources of finance:
financial institutions vs retained earnings
Perception Data on Governance:
Voice and Accountability

173 Countries - ordered by income per capita
(1997/98 comparator also shown for selected countries)

Perception Data on Governance: Control of Corruption

Creating change in the investment climate

- The power of *evidence* for innovation and learning;
- Avoid *policies* to 'institutionalize' opportunities for corruption (e.g., quotas and licenses); e.g. reducing inspections in transition
- Change generated by *competition*, e.g. property rights in Thailand
- *Public action* by policy/social entrepreneurs
- *Press and media*: governance by discussion in civil society
- Creation of *constituencies* and partnerships for reform and change;
- *Conviction and leadership* are necessary to deliver institutional change
Five major challenges in MENA

• **Public sector reform and governance**
  – Politically and socially difficult shift from public sector dominance to private sector economic leadership
  – Need to improve efficiency and effectiveness of public services

• **Private sector development and job creation**
  – Essential to increase investment and create 4-5 million jobs each year to educated youth, a fertile ground for social unrest

• **Education for the global economy**
  – From quantity to quality (tuning to labor markets; global citizenship; tolerance; etc.)

• **Water management in a water stressed region**

• **Gender**
  – Unequal rights in many countries
  – lowest female labor force participation in the world
The Bank’s Response: New strategy and business model in MENA: Balancing strategic lending and knowledge

• Delivering knowledge through lending often not the most efficient vehicle

• The region wants knowledge for many reasons:
  – information gaps, policy change, internal consensus building, international best practice, “seal of approval” to leverage other funds

• Response to demand for knowledge and advice: a new knowledge instrument with all the pros of lending - sustained engagement in activity preparation, implementation, monitoring and evaluation – but without financial transfer if it is not needed.