Explaining FDI Performance of Maghreb Countries

The cases of Morocco, Tunisia and Algeria –
Trade patterns and investment policies

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MSc in Business Administration and Modern Languages
Line: Business and Development Studies
CEMS Master in International Management
Supervisor: Michael W. Hansen

Phillip Siegle
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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AA</td>
<td>Association Agreements</td>
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<td>CSP</td>
<td>Country Strategy Papers</td>
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<td>EU</td>
<td>European Union</td>
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<td>EMFTA</td>
<td>Euro-Mediterranean Free-Trade Area</td>
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<td>EMP</td>
<td>Euro-Mediterranean Partnership</td>
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<td>ENP</td>
<td>European Neighbourhood Policy</td>
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<td>ENPI</td>
<td>European Neighbourhood and Partnership Instrument</td>
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<td>FDI</td>
<td>Foreign Direct Investments</td>
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<td>GFCF</td>
<td>Gross fixed capital formation</td>
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<td>IDP</td>
<td>Investment Development Path</td>
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<td>MENA</td>
<td>Middle Eastern and North African Countries</td>
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<td>MNC</td>
<td>Multi National Company</td>
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<td>MFN</td>
<td>Most-Favoured Nation</td>
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<td>MPC</td>
<td>Mediterranean Partner Countries</td>
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<td>NP</td>
<td>Network Perspective</td>
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<tr>
<td>OLI</td>
<td>OLI Framework – Ownership, Location and Internalisation</td>
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<td>RBT</td>
<td>Resource Based Theory</td>
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<td>RTA</td>
<td>Regional Trade Agreement</td>
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<td>TCT</td>
<td>Transaction Cost Theory</td>
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<tr>
<td>TNC</td>
<td>Trans National Corporation</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>WB</td>
<td>World Bank</td>
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<td>WTO</td>
<td>World Trade Organisation</td>
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Figure 1: Thesis Structure

Introduction
Research Question

Methodology
Research Design
Data Collection
Reliability and Validity

Theory Discussion

OLI &
Investment Development Path

Analysis of Data

Case of Morocco
Case of Algeria
Case of Tunisia

Analysis

Conclusion
1. Introduction

Even though world Foreign Direct Investment (FDI) flows have been growing rapidly, FDI is still decisive - especially for developing economies. As indicated by UNCTAD (2004) international production is now accomplished by over 900,000 foreign affiliates of at least 61,000 Transnational Corporations (TNCs) worldwide and more and more players are integrating in the world's economies. These foreign affiliates make up about one-third of the world exports and one-tenth of world GDP. Recently, outward FDI from developing countries is becoming significant as FDI outflows from developing countries have grown faster than those from developed ones. Outward FDI now accounts to more than 10% of world total stock. Moreover, south to south (i.e. developing countries to developing countries) FDI flows have grown faster than those from south to north (i.e. developing countries to developed countries)\(^1\).

But compared to other developing regions, Foreign Direct Investments (FDI) is lacking behind in the Maghreb region. Investment flows reach other regions but almost neglect Maghreb. Since the Barcelona Process Declaration in 1995 and the proclaimed advancement to reach a Euro-Mediterranean Free Trade Area (EMFTA) in 2010, progress has been slow and not as anticipated. In other words, the economic performance of Maghreb countries falls short in terms of amount and diversification of trade and FDI In- and Outflows. This thesis is a contribution to this on-going debate in the Maghreb among key decision makers and business representatives. An important element of such debate is a clear understanding of the implications and benefits of further integration with regional, European and global markets and resulting FDI inflows and outflows.

The Middle Eastern and North African (MENA) region in general, but also Maghreb countries as such (namely Algeria, Morocco and Tunisia), includes various countries with different economic structures and resources, however these countries have some general common characteristics such as heavy reliance on gas and oil, a weak economic base, high population growth and unemployment rates. Also a dominance of the state in the economic sector, low level of integration with the world, underdeveloped financial and capital markets, underdeveloped institutions, and low rates of returns on human and physical capital are frequently mentioned (Hassan and Bashir, 2002; Makdisi, Fattah and Liman, 2002). Most importantly, MENA countries share similar features as long as FDI related figures are concerned. Therefore, the Investment Development Path (IDP) framework brought in by Dunning (1981) can be a useful tool for investigating the net FDI position of the MENA region in relation to its development, particularly focusing on Maghreb countries.

\(^1\) UNCTAD, 2004
Historically, and particularly throughout the 1980s, many MENA countries have shifted their import substitution policy to export led growth which is regarded as a more open and conducive environment for FDI. According to Soliman, there were two major reasons for this policy change. The debt crisis of many developing countries and the success of export led growth experience in the South East Asian economies (Soliman, 2003). MENA countries have realised many liberalization reforms in order to encourage FDI inflows. Almost all MENA countries have a special FDI regime that refers to a law or decree dealing specifically with FDI\textsuperscript{2}. These reforms include tax and custom duty breaks, relaxed foreign ownership restrictions, and implemented privatization and capital market reform programs (Eid and Paua, 2003; UNCTAD, 2004). This makes Maghreb countries an interesting case for testing the IDP approach. Besides comparing Maghreb countries with respect to their IDP stages, this study also investigates those countries in relation to other parts of the world and incorporates political investment and trade policies between the Maghreb countries and the EU.

1.1 Purpose of the paper

Based on these recent developments in trade and investment policies, the purpose of this paper is to investigate whether the performance of Maghreb countries in terms of FDI changed throughout recent years. Closely related to these criteria is the regional aspect and developments in macro economic fields. As research topic, the Mediterranean area is currently a “hot spot” for investigation. This is, however, mainly due to tensions emergent, immigration flows due to a divergence in income, clashes of culture, energy disputes, war and terrorist deeds. Hereby, socio-political discussions prevail while financial and economic factors are often marginally displayed or neglected.

North Africa is a vast and underdeveloped region. This particular area and developing countries as such typically lack transparency and data to produce scientific research. Thus, this topic is of particular interest to me as I can contribute to enriching the ground for debate of developing countries and FDI as a potential for economic development. Hence, the paper seeks to answer the question whether the Maghreb countries, through the establishment of the EMFTA, benefit from an increase in FDI inflows/outflows and thus possibly enhance performance and competitiveness in the long-run. This question is explored using the North African cases.

The objective can be formulated in the following research questions:

\textit{How have the new EU-Maghreb trade and investment policies affected FDI patterns?}

Therefore the aim is to find out main effects which shaped the relation of EU Maghreb policies and subsequently influenced FDI in- and outflows. Those so called FDI patterns shall be elaborated upon during country analyses.

1.2 Structure
The paper starts out with a methodological section where the research strategy, the data collection process, issues of validity and reliability and delimitations are presented. In the next section, the literature review follows, where most relevant theories and authors are analyzed and discussed. Based on those theories the next section presents a theoretical framework to be used in scrutinizing FDI flows. Subsequently, an analysis starts out with a comparative country assessment of Morocco, Tunisia and Algeria based on the theoretical considerations put forward with the aim of answering my research question. The outcomes are then examined in detail in the following section and provide an answer to the research question. Finally, the paper analyses and discusses the findings in light of the theoretical framework and the propositions put forward as well as verify whether the propositions were relevant.

2. Methodology
The methodology section describes the methods and the research strategy applied in this paper as well as the data collection process and outlines the sources and literature consulted. The aim is to explain the motivations and suitability of the chosen methods to the reader. The section closes with a critique of the applied methods and outlines delimitations.

2.1 Research Strategy
The thesis is built on a country-based methodology and follows a macro-level approach analyzing FDI flows to answer the research questions. A more general comparative study is applied, while an in-depth data analysis gives subsequently insight into country specific performance and explanations of those.

A case study is an intensive examination of a single entity, and according to Yin, is suitable in fields with a lack of theory and experience. As the Maghreb countries are a relatively unexplored part of the world, a country by country methodology is a helpful method in gaining deeper insight and increasing knowledge.

Yin defines the case study as “an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident” (Yin, 2003, p. 13). Hence, developing a case is the most relevant strategy to
answer the research questions as it offers a greater opportunity than other available methods to obtain a holistic view of a specific research project. (Gummersson, 2000, p. 86) Furthermore, the study requires no control of behavioral events and it focuses on contemporary events, which are the criteria defined by Yin (2003 p.5).

In the methodological literature two directions of reasoning are distinguished: the inductive and the deductive research approach. According to Saunders (Saunders, 2003) the deductive approach develops a theory and/or a hypothesis and designs a research strategy to test this hypothesis, whereas in the inductive approach data is collected and theory developed as a result of the data analysis. While gathering data on Maghreb countries, the “progression” of the EMFTA leading to a bonding of the EU and Maghreb countries called for further exhibition in terms of FDI patterns. Thus, this paper originates out of a set of data and follows an inductive approach which maps out relationships between theoretical concepts and then moves towards concrete empirical evidence to confirm or refute theory.

Another distinction is made between exploratory, descriptive and explanatory studies (Gummersson, 2000, p. 85). Sekaran (Sekaran, 2003) defines exploratory studies as a way of better comprehending the nature of the problem since very few information is available in that area. A descriptive study enables to explore new issues and to describe the characteristics of the variables of interest in a situation. (Ibid. p. 121) To understand motivations behind FDI decisions and explaining engagements in other business environments, a mix of exploratory and descriptive views is best suited and thus applied.

In line with the exploratory and descriptive research design, mostly quantitative vs. qualitative data is used in this study. As Creswell affirms, “a qualitative study is defined as an inquiry process of understanding a social or human problem, based on building a complex, holistic picture, formed with words, reporting detailed views of informants, and conducted in a natural setting”. Quantitative data was collected through research and the extensive use of high quality journal articles, reliable sources (such as UNCTAD, EUROSTATS, WB, IMF, etc.) and country specific consultations, which thus put the emphasis on the context in which the phenomenon takes place.

2.2 Data Collection
The study cannot rely on only one source due to its richness and exploratory characteristics. Data collection started as a desk-based research, gathering both primary and secondary data to answer a number of strategic questions. Subsequently, empirical data was collected through independent research.

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3 Creswell, 1994: 1, 2
Primary data is new data gathered to help solve the problem at hand, whereas secondary data has been collected previously by others. Primary data was used in the empirical part of this study through talking and discussing with fellow researcher and my supervisor. Initially, data on Maghreb countries their trade patterns and policies was collected mainly from the multi-lateral organisation such as Eurostats, IMF, OECD, UNCTAD, WorldBank, EU, etc. through press releases, journal articles, presentations as well as newspaper articles.

Secondary data is also the main source of information for the theoretical part of this study and for data on the country profiles. I used both the internet and the library to review relevant articles and books. Numbers on FDI in- and outflows presented were previously compiled by professionals such as industry organizations, well-established international organizations acting as an information service for governments and industry, national banks and non-governmental bodies.

2.3 Reliability and Validity

In order for the research strategy to be valid and reliable, it needs to link the data collected to the initial questions of the study, i.e. methodology and theory need to provide a balance. According to Yin (2003 p.19) this is fulfilled when the paper covers the conditions of reliability, constructed validity, as well as external validity. Reliability is defined as: “The extent to which results are consistent over time and an accurate representation of the total population under study is referred to as reliability and if the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable.” (Golafshani, 2003, p. 598) In other words, reliability is about the “replicability” of the results. This applies as the results are based on facts and thus another researcher following the same research strategy would arrive at the same results. As for validity, “Validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are.” (Ibid. p.599) To guarantee validity and reliability, data is collected from divergent sources of information, including primary and secondary data as well as academic material. According to Neuman (Neuman, 2000, p. 368), this increases internal and external consistency. Together with the use of multiple theoretical perspectives early in the research process this has enabled a triangulation of the results which enhances research validity. Regarding reliability of secondary data, authors and articles consulted are from trustworthy sources such as academic journals and reports, well-known and often cited. Moreover, I decided to use numbers and historical facts by UNCTAD as they prove to be the most accurate ones and as they have the most comprehensive historical data collection and also forecasts available.
The findings of the paper are not based on prior assumptions but on appropriate research methods which allow for an objective interpretation of the results of the data analysis. The paper links existing theoretical and methodological reflections with empirical evidence. In order to retrieve valid and reliable information I conduct a quantitative research process and compile empirical data independently. I am aware of the subjective nature of information made available by exemplification and that data can be manipulated for various reasons in itself. Also the influence of my own expectations and interest on the topic must be balanced through my external standpoint and by consulting different sources. Through this external and differentiating approach I increase reliability and validity of the paper. I critically analyze the huge amount of data received, structure it and filter out the most relevant and reliable information. Moreover, data collected presents facts about country FDI In- and Outflows, which are relatively free of interpretations through personal feelings and perceptions. Finally, I triangulate the data by looking into information provided by different specialized, independent associations and compare it with qualitative data which is less subjective - compared to quantitative material - and adds to reliability and validity of the study. Indeed, also in qualitative research “triangulation strengthens a study by combining methods. This can mean using several kinds of methods or data, including both quantitative and qualitative approaches.” (Golafshani, 2003, p.603) Moreover, Golafshani (2003, p.604) underlines that reliability and validity are conceptualized as trustworthiness, precision and quality in qualitative contexts. Is the study trustworthy, rigorous and therefore generalizable?

Case studies are often criticized for not leading to any general conclusion. Therefore a detailed comparative case study is employed to strengthen the argumentation. Algeria, Morocco and Tunisia are contrasted against each other in terms of e.g. FDI in and outflows, Export and Imports, trade and investment policies and tariffs. To get a broader picture those countries are set into context with other developing nations. This will essentially permit to portrait similarities, differences and explanations for why certain features can or can not be linked to macro economic phenomena.

Strengths of a single case study would have been the ability to produce various sources of evidence and hence to build multiple viewpoints and perspectives on the chosen country. However, limitations of the study are the narrow focus on only one entity, its subjectivity and the influence of personal examinations and perceptions on the study. Although it may present deep insight, a qualitative single case research might encounter difficulties in providing generalizations. Therefore I argue that the comparative analysis results of my research can to a certain degree be generalized to the global Foreign Direct Investment debate and open the door for further IDP discussions.
2.4 Delimitations

I am aware that limitations restrict a study. Restriction, however, were necessary due to time constraints and the pre-defined scope of the paper. Limiting the research was necessary which dismissed different related and appealing topics that could have added value.

The scope of this study requires critical reflection in terms of issues to include and evade respectively. Since the length of the paper is a given, the depth is automatically limited unless acknowledging that a delimitation is required. Moreover, in addition to the necessary yet voluntary delimitation, this study operates within a framework which in itself contains certain limitations. In this section, I account for both.

The thesis examines Foreign Direct Investments, business environments suitable for attracting those sources of investment and potential facilitator and encumber when it comes to attracting FDI. Here the unique characteristics of the three case countries Algeria, Tunisia and Morocco offer explanations which might to a limited extend be used as comparison due to its individual historical and development economic progress. At this stage I solely focus on FDI and do not look at alternative sources of investments. Furthermore, the thesis does not examine or compare different national support schemes, quota systems or direct fixed tariffs and taxes. I put the focus on European FDI into Maghreb and vice versa. Hereby I restrict the geographical landscape and the amount of data. I will however relate data to world wide FDI flows and compare those to other developing countries to establish deeper understanding of the Maghreb cases.

Micro economic features are not analyzed in depth due to the limitations of this paper. The paper does not explain single company investment types and engagements in detail and does not differentiate in particular between long-term and short-term investments which may lead to success-stories or failure. FDI is generally defined as long-term commitment and regarded as a holistic phenomenon.

2.5 Definitions and Explanations

Foreign direct investment (FDI) is the category of international investment in which an enterprise resident in one country (the direct investor) acquires an interest of at least 10% in an enterprise resident in another country (the direct investment enterprise). Subsequent transactions between affiliated enterprises are also direct investment transactions. (EU Yearbook, 2005)

As it gives the investor an effective voice in the management of the enterprise and a substantial interest in its business, FDI implies a long-term relationship between the direct investor and the direct investment enterprise. Investment may take place through the establishment of an entirely
new firm, so-called ‘greenfield’ investment, or through the complete or partial purchase of an existing firm via a merger or an acquisition.

As FDI is discussed in a rather holistic way, and does take little account of their impact on a particular country, region or firm, FDI is perceived beneficial even though much of the desired outcome depends on motivations behind placing an investment and all stakeholders involved.

When touching upon Net Outward Position (NOP) – the same as Net Investment Position (NIP) or Net FDI Position – I aim at establishing a country’s position along the investment-development path (IDP). In merging FDI inflow and outflow data, the net FDI indicates the country’s position (see Dunning and Narula, 1996 and Bellak, 2001). Countries in the process of development take-off usually receive more FDI inflow than the amount they invest abroad (outflow). At an advanced stage, countries become net FDI exporters, or their investment position fluctuates around neutral. Almost all FDI data is taken from the UNCTAD FDI databases or the UNCTAD World Investment Reports.

It should be noted though that the relative size of the FDI inflow is influenced by the size of the country and its development level. To facilitate international comparison it is appropriate to use the relative size of FDI. Thus the most wide-spread indicators FDI per capita and FDI per gross fixed capital formation are used in a comparative analysis.4

The literature generally gives two main reasons for why investors engage in foreign direct investment. Bluntly put vertical and horizontal FDI. A mixture of both is possible and is often the case. Vertical FDI signifies that a company ‘slices’ its production chain by allocating different parts to those countries in which production costs are lower. Progress achieved in recent years in telecommunications and data management has enabled firms to allocate their production processes more easily through so-called supply chain management. On the contrary, horizontal FDI means that a company ‘duplicates’ its production chain in order to place its production closer to foreign markets. The investment decision may result from a trade-off between fixed costs (the new plant) and variable costs (e.g. high tariffs and transport costs associated with exporting to that country). Large markets tend to be more competitive, making imports less attractive, and it is there that major investors tend to carry out this type of investment. Acting as a substitute to trade, horizontal FDI gives investors strategic market access and reduces delivery time. A third possible explanation for FDI are multinational Mergers & Acquisitions (M&A) which take place between companies in unrelated activities seeking to diversify risk and to deepen economies of scope.

In relation to wording, off-shoring is used interchangeably with intra-firm or “captive” investment, Foreign Direct Investments (FDI) and investments abroad. Those concepts imply the same idea as already mentioned above. Taking the centre of investigation to Maghreb countries, investment inflows signify FDI investments originating outside of Maghreb countries. Likewise, outflows mean flows of investments pouring out of Morocco, Tunisia and Algeria.

3. Underlying Theoretical Discussion
The literature review is the foundation on which this research project is based. This literature survey, where I review and discuss the theory and authors relevant to answer the research questions, is the basis for the development of my theoretical framework. It is a merger between theories on the firm, OLI, IDP and FDI theory plus related thinking that explain reasons behind investments abroad. This stipulates that Multinational Companies (MNCs) realise that options for value-adding operations can be found in other countries than their home country. Since this phenomenon is of micro-economic dimension, a better understanding of the firm and its decision making is required (see OLI Framework in the next chapter). Dunning & Narula (1996) argue that while FDI is primarily a micro-economic or firm-specific activity, economic development is a macro-economic or country-specific phenomenon (in Gray 1982). Taking this into consideration the point of departure is the firm which then leads to an accumulation of investments in countries by decisions of the firm to invest. Those macro-economic flows are the outcome and the main interest for this study.

The section commences by defining the concept of Transaction Cost Theory (TCT) and Resource Based Theory (RBT) as essential elements for the development of a framework and its implications for FDI. Even though these two classic theories are at the heart of this thesis, a short introduction and comparison with the Relational View (RV) and the Network Perspective (NT) expand the theory discussion and put theories into perspective.

Further on nature and motivation behind investments will become clear through the appliance of the OLI Framework (Dunning, 1981). Essentially the (L) advantage will beg for further investigation and subsequently introduce the Investment Development Path, which is used to illustrate what countries and MNCs require to let FDI happen. Based on different definitions, my own perspective is presented. This is followed by an outline of advantages and disadvantages of investing abroad and a review of the most relevant theories behind motivations for off-shoring. Finally, different models are examined before the next section presents the application of the theory to the study in my own framework which offers guidance when investigating what FDI in- and outflows to and from Maghreb countries explain. This section applies the theory to the empirical part while taking the shortcomings and criticisms of the theory into account.
3.1 The Theory of FDI and its application
The paper examines a historical set of data of FDI in- and outflows. The underlying framework of the Investment Development Path is the reasoning for why FDI takes place. To understand motivations and determinants for FDI, a thorough appreciation of the underlying theories complements this discussion. Transaction Cost Theory and Resource Based Theory are deemed essential to reason FDI in-and outflows. Based on this conventional thinking, the OLI framework is a useful tool to further lead us to view the economic development stages of Maghreb countries while examining the Investment Development Path in its application (Figure 2). The direction of arrows follows deliberately the logical progression of the paper, but could be seen as dynamic set of theories and frameworks, which interact with each other.

Figure 2: Theoretical Considerations

3.2 Theoretical Explanations for FDI
Different theoretical explanations for FDI exist and have emerged over the years. In the following I review the Transaction Cost Theory (TCT), the Resource-Based Theory (RBT), the Relational View (RV) and the Network Perspective (NP) as I identified them as the most relevant underlying theories to answer the research questions.

3.2.1 Transaction Cost Theory
One approach to determine a firm’s boundaries based on transaction related characteristics is offered by Williamson’s TCT. Williamson combines business economics with organization theory and determines under which conditions a firm should manage a particular economic exchange
within its boundaries and when it should be outsourced (Barney, 1999, p. 137). His theory has been inspired by Coase’s seminal article “The nature of the firm” where transaction costs are seen as the explanation why firms exist (Coase, 1937, Skjøtt-Larsen, 2007). Transaction costs occur through economic exchange and are determined by frequency, specificity, uncertainty, bounded rationality, and opportunistic behavior. (Williamson, 2002)

Williamson argues that firms manage their economic exchanges through different forms of governance: market (arm’s lengths relationships), intermediate (complex contracts or strategic alliances) or hierarchical governance (vertical integration). The form of governance determines the firm’s boundaries, i.e. market and intermediate governance place exchanges outside the firm’s boundaries, while hierarchy manages exchanges within a firm’s boundaries. (Barney, 1999, p.138)

The governance structure however is influenced by bounded rationality and opportunism of individuals. Bounded rationality arises due to incomplete information and information asymmetry about the outcome of a specific action. (Skjøtt-Larsen, 2007, p. 88) Williamson defines opportunism as “self-interest seeking with guile” and as an attribute of human nature. It exists when one party to an exchange takes unfair advantage of other parties involved and is seen as the ultimate cause of failure of markets and for the existence of organizations. (Goshal & Moran, 1996, p.17) Williamson argues that the higher the asset specificity in an exchange, the more likely parties will behave opportunistically. (Williamson, 1979, p. 234) An investment with high asset specificity is something that has significantly more value in this exchange than in any alternative use. (Barney, 1999, p.139)

To protect oneself against opportunistic behaviour, Williamson suggests the introduction of safeguards such as contracts, control mechanisms and penalties (Williamson, 2002). Furthermore, Williamson reasons that a complex interaction between the environment, the individuals and the firm determines the most efficient governance structure. Thus, hierarchy is the most effective form of governance when faced with high uncertainty, high transaction frequency and high asset specificity. In case of medium asset specificity and high transaction frequency Williamson suggests intermediate governance and market governance as the most efficient structure for non-specific assets (Barney, 1999, p.139). Backward integration with suppliers will, according to the TCT, be chosen whenever markets for intermediate inputs and/or raw material bear high transaction costs. Those high costs arise under small-number conditions, i.e. the number of parties in the exchange is small, which is the case in many industries in developing countries or under conditions of information asymmetry, i.e. when the organization cannot distinguish ex ante between good and bad quality. According to Hennart (Hennart, 1991, p. 90), “consistent quality is better assured by vertical integration because it reduces the incentive to cheat at each stage.” Thus, backward integration off-shore instead of outsourcing could be a potential solution to certain quality guarantee - given a supplier originates from Maghreb.
The TCT has been criticized by many authors. Noorderhaven criticized it for being a static theory where only the most efficient governance forms survive. According to him, the theory neglects how transition takes place from one form to another and thus set up a dynamic model where shifts between governance forms are explained, as indeed, business relationships often develop only over a long period of time (Skjøtt-Larsen, 2007, p.89).

Goshal and Moran have criticized Williamson’s TCT as bad for practice as his assumption of opportunism can turn into a self-fulfilling prophecy. They argue that opportunistic behaviour will increase with sanctions and incentives imposed to curtail it which would in turn create an even stronger need for more elaborate sanctions and incentives. Setting up safeguards against opportunism has, according to Goshal and Moran, the opposite effect as outlined by Williamson. (Goshal & Moran, 1996, p. 14) Furthermore, the authors argue that TCT only holds in stable business environments and in stagnant industries. Long-term efficiency is only possible when partners develop trust-based relationships and are willing to share knowledge and experience. Following Williamson’s argument of opportunism, this collective learning is not possible. This goes in line with the criticism brought forward by Olsen who argues that TCT only focuses on minimizing transaction costs to reach efficiency. The theory fails to take the joint value account that can be created by cooperating parties in long-term relationships. Hence, they argue that efficiency should be measured based on maximizing the joint transaction value instead of solely minimizing transaction costs. (Dyer, 1977, p. 538; Skjøtt-Larsen, 2007, p. 91). Furthermore, Williamson’s argument that with increasing asset specificity more complex safeguards and contracts are required to protect against opportunistic behaviour, thus transaction costs increase, is confuted by Dyer in his study of automotive transaction relationships in the USA and Japan. He shows that transactions can achieve the twin benefits of high asset specificity and low transaction costs. He outlines that this is due to the fact that various safeguards to control opportunism have different set-up costs and result in varying transaction costs over different time spans (Dyer, 1977, p. 535).

Finally, Barney criticized TCT for the missing focus on relative capabilities of the firm or of potential partners when deciding what to keep within a firm’s boundaries. If a firm does not possess all the capabilities it needs to be successful, Barney suggests three ways of gaining access. Firstly, a firm can cooperate with firms that already possess the required capabilities through the market or intermediate governance. Secondly, a firm can try to develop the capabilities on its own, i.e. use hierarchy to gain access. Thirdly, a firm has the possibility of acquiring another firm that possesses the capabilities through hierarchy. According to TCT the

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5 Olsen (1997)
choice of governance should depend on the degree of asset specificity. However, Barney argues that there are situations where it might be either too costly or impossible for a firm to develop or acquire the needed capabilities. Reasons are the dependence on historical conditions, path dependence, social complexity or that actions which need to be taken are not fully known or would take too long. (Barney, 1999, p.140) Barney thus reasons that when costs of hierarchical governance are high, a firm might choose non-hierarchical governance forms to gain access to the capabilities, even if transaction costs are high and hence threats of opportunism exist. According to Barney, opportunism is simply a part of the cost of gaining access to special capabilities controlled by other firms which cannot be developed internally or acquired. (Idib. p.143)

3.2.2 Resource Based Theory

Firm's capabilities are also the focus of the RBT which has developed as an important perspective in explaining motivations behind off-shoring and outsourcing. It was first Penrose (1959) who brought forward the idea of looking at a firm as a bundle of heterogeneous resources and capabilities. Elements can also be found in Coase's (1937), Stigler's (1961), Chandler's (1962, 1977) and Williamson's (1975) work who all emphasize the importance of resources with respect to firm performance. Other authors such as Wernerfeldt, Grant, Barney and Eisenhardt have further contributed to the RBT. According to Grant (Grant, 1991), a firm's resources and capabilities provide the basis for a firm's strategy and are the primary source of profit. As opposed to Porter's theory of competitive advantage, where he defines the environment and the industry a firm is surrounded by as the major source of competitive advantages, Grant states that a firm's internal capabilities and resources are a more stable basis to define its identity and strategy. Resources are the basic unit of analysis and constitute inputs into the production process such as capital equipment, skills of individual employees, patents, brand names, finance, etc. Capabilities are seen as the capacity to deploy resources to reach the desired goal. Thus, resources are the source of a firm's capabilities, while capabilities are the main source of competitive advantage. Resources and capabilities include all financial, physical, human, technological and organizational assets as well as reputation. They are owned or controlled by the company and deliver products or services to its customers and can create a sustainable competitive advantage to the company if they fulfil the VRIN criteria: they have to be Valuable in order to enable the firm to follow a value-creating strategy, Rare, difficult to Imitate and Non-substitutable. Those are the firm's “crown jewels” and need to be protected. (Idib. p.129)

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10 Porter’s diamond
Prahalad and Hamel named these central, strategic capabilities “core competences”. They argue that by focusing on only those core competences improved firm performance can be achieved. The RBT thus helps to distinguish between non-core and core competencies based on which make-or-buy decisions should be based. Put simply, core competences should be kept in-house, while non-core competences should be outsourced. Prahalad and Hamel state that a company’s competitiveness derives in the short-run from price/performance attributes of its current products. However, in the long-run, it is obtained from the ability to build core competences at lower cost and faster than competitors. "Unlike physical assets, competencies do not deteriorate as they are applied and shared. They grow." (Prahalad & Hammel, 1990, p. 81) They must however be protected and nurtured. To identify core competencies in a company, the authors suggest three tests. First, a core competence should provide potential access to a variety of markets. Secondly, a core competence should make a significant contribution to the perceived customer benefit of the product or service. Thirdly, they should be difficult to imitate by competitors. (Ibid. p. 83) In that respect it is important to identify which core competencies should be kept and developed in the company including their constituent technologies and map a company’s strategy accordingly including resource allocation preferences. According to Quinn and Hilmer, core competencies are not only products but activities that a company performs better than its competitors. They are seen as a set of abilities and systems which are able to give the end customer high value. (Espino-Rodriguez & Padron-Robaina, 2006, p. 52)

In summary, both the TCT and the RBT are theories that help to determine a firm’s boundaries and thus, choose between in-house production onshore (no FDI) and off-shoring (building or engaging in an affiliate abroad potentially means FDI) or outsourcing on the other hand - depending on the possession of specialized assets. While the TCT explains the negative effects of outsourcing specific assets (outsourcing specific assets can affect the firm’s performance negatively since the risk of opportunistic behaviour increases), the RBT focuses on the positive aspects of keeping core competencies in-house (outsourcing depends on the extent to which the activities permit the exploitation of different knowledge, capabilities and routines within the organization).

3.2.3 Relational View
Even though the RBT attempts to fill the gaps of the TCT, it has been criticized for ignoring external factors concerning the industry in which the firm operates as complementary competitive advantages. Above normal rates of return may be generated by a combination of internal resources and capabilities and external strategic factors. This critique is addressed by Dyer and Singh who argue that the RBT overlooks the important fact that advantages of firms are often
linked to advantages of the network of relationships in which the firm is embedded. Thus, a firm’s critical resources may span its boundaries. (Dyer & Singh, 1998, p. 660) They introduce the RV which is complementary to the RBT, however considers the network as unit of analysis and different sources of competitive advantages. While according to the RBT core competencies are generated within the company itself, the RV identifies relation-specific assets, knowledge-sharing routines, complementary resources and capabilities and effective governance as the determinants of competitive advantages. The authors state that “relational rents are possible when alliance partners combine, exchange, or invest in idiosyncratic assets, knowledge, and resources/capabilities, and/or they employ effective governance mechanisms that lower transaction costs or permit the realization of rents through the synergistic combination of assets, knowledge, or capabilities.” (Ibid. p.662) In summary, according to the RBT firms should protect, rather than share, valuable resources to prevent knowledge spillovers. Opposed to that, the RV argues that rents are jointly created through the systematic sharing of knowledge and know-how. (Ibid. p.675)

3.2.4 Network Perspective
Another theory that looks beyond a firm’s boundaries is the NP. It takes a socio-economic perspective on industrial networks, and focuses on the value of business relationships. The underlying assumption is that the individual firm depends on resources controlled by other firms to which it can gain access through interaction. The three components activities, resources and actors and their mutual relationships define the dyad. The actors are defined by the resources they control and by the activities they perform. Relations between firms in the NP are developed through exchange and adaptation processes. The former include exchange of information, goods and services, social processes, etc. The latter include mutual modifications of products, administrative systems and production processes. The value of resources is determined by combinations with other resources. This is why a firm’s continuous interaction with other players is a crucial factor in developing new resources. Thus, a firm’s relations with other firms are often seen as the most valuable resource. A firm is thereby able to influence not only the direct players but also the indirect players in the network. (Skjøtt-Larsen, 2007, p. 93)

3.2.5 Summary
The table below summarizes the main characteristics of the four theories outlined above which must be seen as complementary. It is not possible to rely on only one theory when one seeks to explain motivations behind off-shoring.
Table 1: Summary of Theoretical Perspectives

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>TCT</th>
<th>RBT</th>
<th>RV</th>
<th>NP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assumption</td>
<td>Bounded rationality, Opportunism</td>
<td>Bounded rationality, Trust, Firm as bundle of resources</td>
<td>Resources span firm boundaries</td>
<td>Bounded rationality, Trust, Dependence on resources controlled by other firms</td>
</tr>
<tr>
<td>Unit of analysis</td>
<td>Firm</td>
<td>Firm</td>
<td>Pair/network of firms</td>
<td>Network/dyad of firms</td>
</tr>
<tr>
<td>Focal point of analysis</td>
<td>Transaction attributes</td>
<td>Resource attributes</td>
<td>Relational rents</td>
<td>Inter-firm relations</td>
</tr>
<tr>
<td>Problem orientation</td>
<td>Efficient governance structure, Why do firms exist?</td>
<td>Internal competence development, Why do firms differ?</td>
<td>Inter-firm long-term collaboration</td>
<td>Dynamic relationships, How to interact with other firms?</td>
</tr>
<tr>
<td>Time dimension</td>
<td>Static</td>
<td>Static/dynamic</td>
<td>Dynamic</td>
<td>Dynamic</td>
</tr>
<tr>
<td>Nature of relationship</td>
<td>Market failures</td>
<td>Access to complementary resources</td>
<td>Access to jointly created resources</td>
<td>Access to heterogeneous resources</td>
</tr>
<tr>
<td>Domain of interest</td>
<td>Exchange and the transaction</td>
<td>Firm resources and capabilities</td>
<td>Related networks</td>
<td>Exchange and adaptation processes</td>
</tr>
</tbody>
</table>

4. Constructing a Framework

OLI
The IDP theory was introduced by Dunning (1981) as an extension of Eclectic Paradigm - or OLI framework - to explain the net outward investment position of countries in relation to their development stages. The Eclectic Paradigm suggests that the direct investment stock of countries is determined by three factors: ownership, location and internalization (OLI) advantages.

Ownership advantages (O) describe the net competitive advantages of a domestic firm relative to the firms of other countries such as patents and trademarks, managerial know-how, scale or preferential access to raw materials and/or to markets. These are terms often related to the RBT. However, in terms of the TCT a firm that possesses (O) would be exposed to low transaction cost. Those could denote e.g. infrequent transactions, low asset specificity, certainty in the market and no opportunistic behavior of the players.

Dunning (1995a) argues that FDI may be explained by locational factors such as the extent and nature of the location (L) bound endowments and markets offered by countries to firms to create or add further value to their competitive advantages. The extent to which the market for these advantages is best internalised by the firm itself (I), rather than marketed directly to foreign firms.
define the internal composition of the firm’s strategy. In other words, internalization advantages of
a firm define the perception of the firm as more profitable to exploit the ownership advantages in
the international markets instead of selling them to other firms. Consequently, FDI takes place.

As stated by the “internalisation paradigm” there are advantages of internalising the market in
order to appropriate the full economic rent created by core assets. (Dunning, 1995 a, p.81). This
could be explained via the TCT through control of the parent company. Control could minimise
opportunistic behaviour while at the same time giving confidence to operations. RBT would regard
resources and knowledge as key element which would be kept in-house – hence avoiding rent
seeking behaviour of other players in the market. Thus, location advantages identify the host
country’s attractiveness relative to others such as physical distance, labour composition,
wages, infrastructure, economic and political system, etc.

Especially the (L) advantage leads to the proposition of the Investment Development Path (IDP)
theory, which suggests that the country passes through five main development stages determined
by the changes in the OLI parameters of domestic firms and the country (Dunning and Narula
1996). These changes affect the international investment position of the country with respect to its
development. Dunning and Narula demonstrate the change in investment position of a country
with changes in its net outward investment (NOI: outward FDI minus inward FDI) and the
development with country’s gross domestic product (GDP) level.

IDP
In the first stage of IDP, outward FDI of the country is at a negligible level or zero because of
insufficient ownership advantages of domestic firms. The inward FDI level of the country also
remains at a low level as a result of limited market demand related to low income level, insufficient
government policies in promoting FDI, inadequate labour force and infrastructure (Dunning and
Narula 1996). In the second stage of IDP, outward direct investments remain still at a negligible
level but inward FDI begins to rise as the location advantages of the country improves, particularly
with the help of government policies. As the ownership advantages of the firms improve, firms
become more competitive and internalization of international markets becomes more attractive.
Eventually, the rate of outward FDI begins to increase in the third stage of IDP. At this stage,
along with the decrease in the growth rate of FDI inflows, the net outward investment (NOI) level
(outward FDI minus inward FDI) of the country rises. In the fourth stage, outward FDI of the
country becomes equal to or greater than its inward FDI. During this period, location advantages
of the country are assumed to depend mostly on the location-bounded created assets that are not
independent of natural resources. As the ownership advantages of the domestic firms become
similar to the firms in other fourth stage countries, inter-industry trade and inter-industry FDI
increases between these countries. Finally, the NOI level of a country fluctuates at the zero level in the fifth stage of IDP while the growth rate of both inward and outward FDI continues to rise. Dunning (1981) and Dunning and Narula (1996) have analyzed the IDP stages of a group of countries using cross-section data, and have used gross domestic product (GDP) as a representative of the countries’ development level.

Table 2: The Five Stages of the IDP and Classifications

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Level of FDIs: Countries with little or no inward FDI and no outward FDI (FDI net balance negative)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Type of L. advantages: Countries with limited L. advantages. Have not fully developed related asset L. advantages. The major L. advantages are in natural resource endowments.</td>
</tr>
<tr>
<td></td>
<td>Inward FDI received: primarily natural resource seeking and secondary, market-seeking</td>
</tr>
<tr>
<td></td>
<td>The most relevant L. factors are:</td>
</tr>
<tr>
<td></td>
<td>Abundant natural resource</td>
</tr>
<tr>
<td></td>
<td>Custody of raw materials</td>
</tr>
<tr>
<td></td>
<td>Limitless or no domestic industry</td>
</tr>
<tr>
<td></td>
<td>Support sectors undeveloped</td>
</tr>
<tr>
<td></td>
<td>Few indigenous &quot;clusters&quot; of related activities</td>
</tr>
<tr>
<td>Stage 2</td>
<td>Level of FDIs: Countries with growing inward FDI and little outward FDI (FDI net balance positive)</td>
</tr>
<tr>
<td></td>
<td>Type of L. advantages: Countries with limited L. advantages. Have not fully developed related asset L. advantages but some of them begin to invest in them. The major L. advantages are in related natural resource environments.</td>
</tr>
<tr>
<td></td>
<td>Inward FDI received: primarily natural resource seeking and market-seeking</td>
</tr>
<tr>
<td></td>
<td>The most relevant L. factors are:</td>
</tr>
<tr>
<td></td>
<td>Abundant natural resource</td>
</tr>
<tr>
<td></td>
<td>Custody of raw materials</td>
</tr>
<tr>
<td></td>
<td>Limitless or no domestic industry</td>
</tr>
<tr>
<td></td>
<td>Support sectors undeveloped</td>
</tr>
<tr>
<td></td>
<td>Few indigenous &quot;clusters&quot; of related activities</td>
</tr>
<tr>
<td>Stage 3</td>
<td>Level of FDIs: Countries with growing inward and outward FDI (FDI net balance positive)</td>
</tr>
<tr>
<td></td>
<td>Type of L. advantages: Countries in which created assets L. advantages are developed.</td>
</tr>
<tr>
<td></td>
<td>Inward FDI received: primarily market seeking and to a lesser extent strategic resource seeking and natural resource seeking.</td>
</tr>
<tr>
<td></td>
<td>The most relevant L. factors are:</td>
</tr>
<tr>
<td></td>
<td>Well developed infrastructure</td>
</tr>
<tr>
<td></td>
<td>Intermediate quality created assets</td>
</tr>
<tr>
<td></td>
<td>Comparative disadvantage in natural assets</td>
</tr>
<tr>
<td></td>
<td>Improving cluster related opportunities</td>
</tr>
</tbody>
</table>

In a nutshell:

The Net Outward Position (NOP) of a country (outward investment – inward investment) follows five stages of development which are closely related to the economic development of the country.

- **Stage 1**: Least developed countries attract and undertake negligible amounts of FDI.
- **Stage 2**: Developing countries attract increasingly FDI as a result of cheap inputs; as a result of FDI, domestic investors enhance their own ownership advantages through spillovers; local advantages are also upgraded.
- **Stage 3**: The developing country becomes an outward exporter itself; expansion is in neighbouring, culturally similar countries conform with the Uppsala School (Johanson and Vahlne, 1977; 1990). Investment in developed countries occurs as well.
- **Stage 4**: The country becomes a net outward investor, revealing the level of economic development as well as the dynamism of local firms.
- **Stage 5**: This stage describes developed economies i.e. the USA, the UK, Germany with high volumes of inward and outward FDI.
Based on the above mentioned pattern of FDI In- and Outflows – converted into the NOP – a progressive increase in NOP is apparent. Visualised, a typical development from stage 1 to 5 would - in theory - be portrayed as in the graph underneath.

**Figure 3: Net Outward Positions of Countries in different Development Stages**

(Graph adopted from presentation Filippaios and Tzioumis, 2008, LSE)

### 4.1 Theoretical Framework

In the following section I develop the important linkage between theory and practice. I link the theories presented above with the empirical part of the thesis by applying and combining the relevant theories in a framework that is suitable to answer the research questions put forward. As the existing theories and models are not sufficient to explore the reasons for the poor Maghreb FDI performance, different theories and models are merged and applied to the unique characteristics of countries and its current issues. Through combining and applying different models to a new context, I am filling in gaps and provide answers and explanations that the current theory does not provide.

In order to be able to assess both the motivations and essential key components for proper FDI investment climates, I suggest a multi-dimensional approach. This approach can be used as a tool which helps identify the respective explanation for FDI environments and reason behind such settings. Underneath, the theoretical foundation - which is the guideline used throughout the literature review and continues to be the underlying assumption for the analytical part – is portrayed. It dedicates room for the firm as a basis to start from. FDI emerges from a decision to
invest abroad. Here the OLI with its multi-layer consideration paves the way for a better understanding of what considerations and elements must be met before a firm invests.

Figure 4: Theoretical Foundation For Framework

Research on the determinants of FDI indicates that a plethora of factors could influence FDI location decision. Possibly, such reasons are to extract raw materials, to expand markets, to seek cheaper sources of labour to produce goods and services for exports to home markets and elsewhere, for taking advantage of tax systems, and to obtain other free and/or subsidized benefits from the host country have been put forward. Zaman (2004) argues that non-economic factors have been neglected when discussing motives of FDI. In his view decision-making structures in host countries, continuity of political and economic powers, established procedures for dealing with foreign MNC and levels of transparency and accountability deserve a more thorough discussion.

Coming back to the more obvious motives of FDI, Market-size is reported to be one of the most significant determinants of FDI flows. Bandera and White’s (1968) study of US manufacturing FDI in different European countries found a strong correlation between the level of FDI and the level of national income in the host country. Using aggregate data on a large number of developing countries, Root and Ahmed (1979) found per capita GNP to be a dominant variable in determining FDI in developing countries.
Dunning (1988) on the other hand found *availability, cost and access to raw materials and labour supply* as having a strong effect on the location of FDI. Literature indicates that the lower the cost of labour, the more attractive the country is to FDI. Tsai (1994) found that while lower labour cost attracts more FDI, higher labor cost discourages inward FDI.

Another crucial factor and often mentioned is *political (in) stability*, which was found to have an impact on inflow of FDI. Schneider and Frey (1985d) and Bollen et al. (1982) noted that political instability significantly reduces the inflow of FDI. Another researcher found that investors report political instability as the most important factors influencing their FDI decision. Welfens (1993) argued that in transition economies such as Eastern and Central European countries, political stability is needed to attract FDI. In principle, research indicates that political stability is a pre-requisite for FDI to occur but is not a strong motive for inward FDI\(^\text{11}\).

*Economic stability* is also conveyed to be a key determinant of FDI (Goodnow and Hansz 1972, UNCTAD 1998). In addition economic stability must be accompanied by political stability in order to affect positively inward FDI. Put differently, *foreign investors will be deterred by political and economic instabilities but will not be motivated to invest because the country is economically and politically stable – they are necessary condition for FDI to occur but are not enough on their own*. The two factors matter when accompanied by other motives (UNCTAD, 1998).

Amid other key determinants of FDI that have received interest in the empirical literature, are *economic growth* (Root and Ahmed (1979), *infrastructure* (Wheeler and Mody (1992), *geographical proximity and transportation costs* (e.g. Goodnow and Hansz 1972) *tax incentives* (Root and Ahmed, 1979), *investment policy of host countries*, and the level of *industry competition* in the host market\(^\text{12}\).

The significance of host country factors may differ depending upon the country in which the firm originated. Pauly and Reich's (1997) study on the practices of US, Japanese and German multinationals provided rich evidence that, despite globalization, considerable nationally-based differences between multinationals persist. For instance, German and Japanese firms obtain most of their financing through banks, while US firms rely primarily on capital markets. By implication, nationally-based differences may influence firms’ decisions on FDI location. A study by UNCTAD (1998) noted that foreign investors may respond differently to different *types of motives* depending on *their strategies*, which are subsequently influenced by their country of origin (Stopford and

\(^{11}\text{UNCTAD, 1998}\)

\(^{12}\text{e.g. Goodnow 1985, Porter}\)
Wells, 1972). One reason for country of origin variations, which is of relevance to this article, is geographical and cultural proximity between a firm’s home country and the target FDI location. By extension, even though one could argue pro geographical proximity and historically and culturally affiliated relation between the EU and Maghreb countries, I assume that factors such as cost of labour, natural resources, high purchasing power, and the political and economic stability are of interest to companies from EU countries. Conversely, American and/or Asian companies might base their location decision on other factors.

The industrial sector could also affect incentives favoured by foreign firms. Already in the early 1970s, Dunning (1973) considered the possibility that FDI motives vary between industries. Manufacturing, for instance, may differ substantially from service operations and/or agriculture. Manufacturing investments generally require much larger investments in fixed assets, such as land and equipment, than do service companies. As a result, incentives related to the acquisition of assets or availability of natural resources should be of less interest to service firms. While some empirical studies found that FDI determinants did not differ significantly between sectors (e.g. Miller 1993) other studies implied different conclusions. With respect to socio-political risk, different authors (e.g. Kobrin 1978) suggested that different types of socio-political events have diverging effects on different industries thus, by implication a firm’s response to socio political instability differs by sector.

A number of empirical studies suggested or implied that FDI motives may differ between sectors. Based on an investigation of 118 foreign plants constructed or purchased by US firms, Bass et al. (1977) found that different industries emphasise different factors in FDI. For instance, while labour intensive electrical firms were more concerned with wage rates, capital intensive chemicals firms put more emphasis on shared ownership. In a study of the effect of socio-political instability on the flow of US investment, Fatehi and Safizadeh (1994) found that socio-political events affected different sectors in different ways. By examining three forms of FDI – manufacturing, mining and petroleum, the authors found a diverging effect of political instability on the flow of these three forms of FDI. Taken together, the theoretical explanations for off-shoring offered by the TCT, RBT, RV and NP suggest the following: According to the TCT, the decision whether to use the market, hierarchy or intermediate governance forms to off-shore is to a large degree influenced by the level of transaction costs involved as well as bounded rationality and opportunism which rise with the degree of asset specificity.

To conclude: political and economic stability are predetermined factors that are the basis to attract FDI. Other than that sectors and industries perform differently when deciding to invest abroad and
thus respond only to certain **industrial policies**. Naturally, locational factors are a detrimental factor for attracting FDI, also in term of creating certain sectors and industries.

**Figure 5: Framework for Analysis**

![Framework for Analysis](image)

5. Analysis
The following section applies the propositions put forward in my own framework to the case countries. In order to understand the dynamics and current challenges of the Maghreb countries, a macro perspective is discussed. Thus, this section starts with a presentation of the current political agenda surrounding and influencing Maghreb countries. Subsequently, motivations for trade and potential integration are examined while trends of nation-wide policy formulations are compared. Later on, a narrow investigation of factor endowments and trade patterns of important industries of Maghreb depict locational settings while keeping key investors in mind. Concluding, those factors will be tested against my suggestions in a comparative analysis, before a detailed positioning of Maghreb counties, as regarded via the Investment Development Path, takes place. This will eventually answer the research question about delicate Maghreb FDI patterns.

5.1 Case Presentation
In this section, the three Maghreb countries are portrayed in terms of political systems and recent trade and investment policies to eventually exhibit similarities and differences in their FDI flows, stock and gross fixed capital formation (GFCF). As outflows in particular are minimal, a
percentage of GFCF is not included. Algeria, Morocco and Tunisia are compared to other parts of the world and in contrast to the developing countries and developed countries to complementarily position them.

5.1.1 Algeria's policies
According to UN estimates, “The People's Democratic Republic of Algeria” has a population of 33.9 million (UN, 2007). President Abdelaziz Bouteflika secured a landslide election victory in April 2004 and is still governing. He promised to seek “true national reconciliation” during his now second term (BBC).

Among the areas open to foreign investors in Algeria are the huge reserves of natural gas and other hydrocarbons. The country is the largest supplier of natural gas to the European Union (EU). It projects to increase oil and gas revenue over the coming decade and so the government is eager to attract substantial foreign investment to the sector. The Government of Algeria announced in 2002 that it would privatize, either fully or partially, 100 state-owned firms. However, in 2005, Algeria altered its strategy towards investment in the oil and gas sector to increase the share of Sonatrach, the state-owned oil and gas company, in all exploration and production contracts awarded to foreign investors.

Algeria is a member of the Arab Maghreb Union, New Partnership for Africa's Development and the African Union. In 2001, the country signed the Trade and Investment Framework Agreement (TIFA) with the United States, effectively establishing the common principles on which the economic relationship is founded. Algeria also initialed an accord as part of the European Union’s drive to build stronger relations with neighbors in the southern and eastern Mediterranean. Central to the agreement is a dismantling of trade barriers over 12 years. It is expected that these will lead the country to implement more reforms, especially in the banking and finance industries and ultimately boost FDI inflows into Algeria.  

13 UNCTAD, WID, Country Profile: Algeria
Coming from nearly zero, FDI inflows to Algeria augmented steadily to reach its current peak at $1.8 billion. After a global boom, 2002 marked the second highest level since 1990, even with a decline of 11%. The high levels of inflows were explained by an increase in oil and gas explorations, bolstered by economic reforms that are taking place in the country. FDI outflows also witnessed growth between 2001 and 2002 (Figure 6). Inward FDI stock multiplied fourfold between 1995 and 2002 and almost doubled between 2002 and 2006. They increased from about $1.5 billion in 1995 to nearly $6 billion in 2002 to more than $10 billion in 2006. (Figure 7)

FDI inflows as a percentage of gross fixed capital formation grew from around 0% in the 90s to about 4% in 2000 to over 8% in 2001 before levelling out around 5%. (Figure XX).
5.1.2 Morocco’s case

Although the fourth largest country in the region, Morocco has a rather small but open economy, its degree of openness is now close to 70% of GDP. Morocco has recently experienced an improvement of its average GDP growth to some 5.5% (from 3.2% in 2002). The country recorded another current account surplus in 2003, with stronger investment activity and sustained private consumption\(^{14}\).

With a population close to 30 million, Morocco’s “constitutional, democratic and social monarchy”, lead by King Mohammed VI, controls and economy amounting to $37,263 million (GDP 2002)\(^{15}\). It is highly dependant on agricultural production, which accounts for roughly 14% of GDP but involves more than 50% of the labour force. The dependency on agricultural output and erratic meteorological conditions has traditionally led to a high volatility in the growth rate. The slow growth rates in the 1990’s translated into a stagnant per capita income level of €3.690 (PPP) in 2002. The economy has not been able to alleviate pressures stemming from the rapidly increasing labour force (population growth, although declining, is still 1.7 %). Unemployment levels remain high (over 20% in urban areas).

Following an economic crisis in 1983, the government substantially reduced trade protection, cut the fiscal deficit, and rescheduled its external debt. While the 1990s have been characterised by a high degree of macroeconomic stability, a slippage in fiscal discipline has been noted recently. With regard to economic growth Morocco’s performance has been disappointing over the last decade, declining to an average 2.3% per year compared to an average of 4% in the 1980s. Lower growth rates were mainly due to external developments (six droughts in ten years, slow European growth) as well as stagnating overall structural reforms. Progress in recent years includes, among others, the modernisation of the customs administration, the privatisation of public enterprises, telecommunications reform, and trade liberalisation in accordance with the Association Agreement with the EU. Since 2001, the growth rate has improved, rising to 5.5% in 2003. This improvement reflected the 20.6% increase of agricultural output\(^{16}\).

Morocco has a wide scope for FDI because of its abundant natural resources. It is the world's largest exporter of phosphates - both raw phosphates and processed products, including phosphoric acid and fertilizers\(^{17}\). Other minerals including silver, zinc, copper and Cobalt are also extracted. Manufacturing is dominated by the clothing and textiles industry while there are small but growing electrical and mechanical industries.

\(^{15}\) Morocco and the Foreign Assistance in the Economic Development, Presentation: Zakaria Bekka
\(^{16}\) ibid
\(^{17}\) UNCTAD, WID. Country Profile: Morocco
Morocco has continued to make its economy attractive to foreign investors by reforming investment laws, liberalizing trade and prices, reducing red tape, updating the financial system, privatizing some state firms and offering concessions in telecommunications, power generation and water management.

Under the privatization and liberalization programme, the telecommunications sector has been opened to competition and is expanding rapidly with new services and new platforms. The state telecommunications regulator, Agence nationale de régulation des télécommunications (ANRT), has overseen the liberalization of the sector.

Morocco is increasingly integrated into the regional and international economic systems through its membership in the regional integration schemes such as the Arab Maghreb Union, and the Association Accord with the European Union\textsuperscript{18}. However, aside from privatisation, UNCTAD proclaims that the overall FDI flows have remained at a rather low level. Measures have been taken to reinforce the legal environment for investors and to improve so-called “welcoming services” for foreigners. In January 2002, a new decentralised investment service was launched and regional investment centres are being opened, although they still lack resources to function efficiently. The main obstacles for foreign investment relate to i.e. complicated procedures for business registration and a lack of transparency in the regulatory framework. Another aspect are rainfall levels, which can influence the annual growth rate. It is said to have a high degree of volatility, in line with rainfall levels, which continue to determine the economic situation. Other estimates suggest that Morocco's growth potential is limited, due to its over-reliance on the agricultural sector, limited internal market and low total factor productivity\textsuperscript{19}.

Figure 9 & 10

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\textsuperscript{18} UNCTAD, WID. Country Profile: Morocco

\textsuperscript{19} Morocco and the Foreign Assistance in the Economic Development, Presentation: Zakaria Bekka
Growth in FDI inflows to Morocco has widely fluctuated since 1996, and in 2002 it took a nose dive, from $2.9 billion in 2001 to $533 million in 2002. The downturn in 2002 was a return to the normal level after an exceptionally large acquisition that took place in the telecommunications sector in 2001. However, the graph portraits the bouncing back and recent ups and down with a current levelling out at around $3 billion. FDI outflows followed a similar pattern, declining from $97 million in 2001 to $29 million in 2002 before climbing up to $500 in 2006 (Figure 9). Inward FDI stock surged from less than $1 billion in 1990 to almost $10 billion in 2002. Outward FDI stock reached its highest point, at a little above $0.8 billion in 2002 (Figure 10).

**Figure 11**

FDI inflows as a percentage of gross fixed capital formation (GFCF) declined from 38% in 2001 to 6% in 2002. Since 1996 this yearly up and down is visible, where jumps from around 7% to around 20% are common. In 2005 and 2006, however, a rather high level of above 20% was reached.

### 5.1.3 Tunisia’s situation

With about 10 million inhabitants, Tunisia followed a period of high growth rates (5.2% on average for the period 1997-2001). However a combination of negative domestic and external shocks led to a modest GDP expansion of 1.7% in 2002. An export-led recovery followed in 2003, driven also by increased agricultural production. GDP grew 5.6% in 2003. Export revenues increased by
around 12% in the first eight months. The Iraq crisis and the Casablanca terrorist attack had an impact on the tourism industry in early 2003, although relatively moderate (tourism fell by 9\%).^{20}

Thanks to prudent macroeconomic management, Tunisia is experiencing a relatively high degree of price stability with inflation levels well below 5% since the second half of the 1990’s. Tunisia is a constitutional presidential republic. The President of the Republic is the Head of the Executive. He is elected by universal suffrage. The current President, Zine El Abidine Ben Ali, has been in power since 1987 and in the last elections in 1999 received 99.4% of the votes.\(^{21}\) The Government has been particularly keen to encourage foreign investors to invest in manufacturing plants in Tunisia to serve the European market by offering attractive investment incentives to export-oriented investments. For example, exporting companies can import all necessary capital goods and production inputs custom duty free. They are also fully exempt from income tax for the first ten years of activity followed by a 50% reduction in income tax thereafter. Foreign investors can hold up to 100% of the project capital without prior authorization, except for exporting service industries which are subject to authorization if the foreign participation exceeds 50% of the capital.

From 1995, privatization was sped up and by 2005 the government had disposed of large businesses. About 160 public enterprises had been fully or partially privatized or been shut down and their assets sold off. Foreign investors also benefit from the off-shore status of wholly exporting companies: whether in the form of off-shore factories which can be set up anywhere in Tunisia, or within a free zone. Two free trade zones are set up in Tunisia, one in Bizerta and the other in Zarzis. The incentives offered by these free trade zones strengthen the interest already shown by foreign investors in Tunisia.

Oil has played a large role in attracting FDI to Tunisia and exploration remains buoyant. The law concerning exploration activities was revised in early 2000 to give the government greater flexibility in fixing terms with operators, taking into account exploration costs, field size and changing world oil and gas prices. This cleared the way for an expansion of petroleum activities. Approximately 43 exploration permits were in operation in 2002. The British Gas investment in the Miskar gasfield in the early 1990s is still Tunisia’s largest single foreign investment.

Non-energy foreign investment did not rise much until 1998, despite many initiatives to encourage it. However, since 1998, the main focus of FDI has been on manufacturing. After the cement sector, the textiles industry has attracted the most foreign investment, followed by shoes and leather, vehicle parts, electronics, pharmaceuticals, food, and computer software. The tourism

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\(^{21}\) Ibid
sector is also growing in importance. The main investors are from European companies – mainly France, the United Kingdom, Germany and Italy, and the United States.

Tunisia has good infrastructure, a reasonably well-trained and adaptable workforce, enjoys proximity to Europe and is improving its integration into the world economy. The country is provided free access for industrial goods to European markets through its Association Agreement with the European Union (EU), and reduced customs duties for exports to the United States, Canada, Switzerland, Australia and Japan. It is the first country of the southern shore of the Mediterranean to have signed an association agreement with the EU. This agreement, signed on 17 July 1995, extends cooperation to culture, education, economy, scientific research and political and social dialogue. It provides for the gradual establishment, over a period of 12 years, of a free-trade zone for industrial products (EMFTA). Another agreement on agricultural trade with the EU came into force on 1 January 2001. The agreement raised Tunisia’s annual quota for duty-free exports to the EU and fixed other quotas for other agricultural items. In return, Tunisia agreed to remove import duties on European wheat and vegetable oil imports over five years\textsuperscript{22}.

Tunisia also signed free-trade agreements with Egypt, Morocco, Jordan and Libyan Arab Jamahiriya. In 2001, Tunisia signed a declaration with Egypt, Morocco and Jordan calling for a free-trade zone among the Arab states of the Mediterranean, which is to become a precursor to the proposed Arab free-trade area. At the end of 2005, Tunisia belonged to major integration schemes such as the Arab Maghreb Union, African Union, New Partnership for Africa’s Development and World Trade Organization. Tunisia also supports the “Eizenstat plan” to develop trade links between the United States and Tunisia, Morocco, Algeria and Egypt. Out of all pending initiatives however, only the EU partnership has so far become a reality\textsuperscript{23}.

\textbf{Figure 12 & 13}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{FDI_Flow_Stock_Tunisia_1980-2006.png}
\caption{FDI Flow Tunisia, 1980-2006}
\end{figure}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{FDI_Flow_Stock_Tunisia_1980-2006.png}
\caption{FDI Stock Tunisia, 1980-2006}
\end{figure}

\textsuperscript{22} UNCTAD WID Country Profile: Tunisia
\textsuperscript{23} European Neighbourhood Policy: Country Report Tunisia, The Commission of the European Communities, 2004
FDI flows to Tunisia, in 2002, reach a height since 1990 and almost double the total inflows recorded in 2001. The FDI inflows to Tunisia in 2002 were determined by investment in oil exploration activities and manufacturing sectors. The peak was reached by a fourfold increase from 2005 to 2006 (totalling $3.3 billion). FDI outflows, on other hand, were small throughout the last decades touching the maximum of $33 million in 2006 (Figure 12). Inward FDI stock grew from $11.7 billion in 2001 to $14 billion in 2002. Outward stock also increased from $33 million in 2001 to $37 million in 2002 gradually rising over the past years (Figure 13). Yet, outward stock and flows are a visibly tiny fraction of inflows and its corresponding stock.

Figure 14

![Inward FDI flows as a percentage of Gross Fixed Capital Formation, by host region and economy, 1970 - 2006](image)

As a percentage of the gross fixed capital formation, FDI inflows has grown in importance from 9.3% in 2001 to a little over 13% in 2002 hitting the rather extreme level of 46.6% in 2006. For outflows, it was insignificant and indicated levels of between 0.0% and 0.5% of GFCF in 2006 (Figure 14)

5.2 Discussing the Net Outward Position (NOP)

In order to determine the IDP stages of each country, changes of NOP (alternatively Net Outward Investments NOI) position with respect to GDP level for each country are analysed. In the explanations beforehand it was mentioned that at the first stage of IDP a negative NOI is accompanied with a low GDP level. As the inward FDI increases, the NOI level of the country tends to decrease and the GDP level to rise relative to the first stage.
A country shifts to the third stage of IDP when its outward FDI begins to increase while its inward FDI growth rate decreases and the NOI level of the country tends to rise with respect to the change in its GDP level. At the fourth stage of the IDP, a country's outward and inward FDI levels become equal initially and later the outward FDI exceeds the inward FDI. Therefore, the NOI level of the country increases to positive values. The fifth stage is characterised with rising levels of both inward and outward investment and the NOI level fluctuates around zero. Appendix V shows the NOI position of selected MENA countries' with respect to their GDP levels.

Referring to a study done by Divarcy et al.\textsuperscript{24} Algeria, Morocco, and Tunisia are at the second stage of IDP due to their increasing inward and low outward FDI - thus a decreasing NOI level. However, the NOI and GDP scatters (Appendix V) do not allow one to make a prediction about their IDP stages. For example, Libya has negative inward FDI over the period, i.e., the foreign investors have disinvested in the country after the UN sanctions. Also, the political environment of Iran might have prevented FDI inflows since NOI position of the country is close to zero. In Kuwait, inward FDI is very low compared to outward FDI stock of the country therefore the NOI position of the country demonstrates positive values for the period considered.

Although the scatter diagrams suggest that Algeria, Morocco and Tunisia are at the second stage of IDP, the empirical results do not support this observation for Algeria. Qatar, which has mostly eliminated FDI restrictions and strengthened legal protections, has location advantages depending on its natural resources. Tunisia is a little different from Qatar; they have attracted increasing FDI inflows to industries such as tourism, automobiles, electronics and infrastructure (UNCTAD, 2004). They have recently begun to attract efficiency-seeking FDI in such industries as textiles and apparel. This change can be interpreted as a sign of moving to the third stage of IDP particularly in some industries. Qatar poses a good portrait with its political stability, relatively well developed infrastructure and an efficient stock market as far as location advantages go.

\textsuperscript{24} Foreign Direct Investment and Development in MENA Countries, Divarcy et. al
Figure 15: NOP of Maghreb Countries compared to other countries

Trying to depict many countries and their NOP, one can reckon the vast differences between the two groups developed and developing countries. Not surprisingly, only developed countries display a largely positive NOP. All other mentioned countries such as Poland, Mexico, China, India as well as Maghreb countries are negative. China, as an enormous net receiver of FDI, is visible whereas the others are barely noticeable with this scale.

The graph on the next side (Figure 16) shows that Mexico, India and to a lesser extent Poland have moved downwards quite rapidly since the early 90s. Less movement is visible in the case of Tunisia, Algeria and Morocco. This could indicate that those countries are at an earlier stage in their respective development. Even though the other countries are developing nations (except Poland, which UNCTAD included in “developed” Europe) a quite drastic difference in the amount of Inflows vs. Outflows is evident.
Figure 16: NOP of Maghreb Countries in relation to Poland, Mexico and India

Figure 17: NOP of Maghreb Countries
Even between Maghreb countries, immense differences persist. More variation can be seen from 1996 onwards as Maghreb countries received more inflows of FDI while keeping outflows at a constant low level. Regarding the whole region, but clearly visible in the case of Morocco, FDI flows to the Maghreb countries vary greatly from year to year, depending on the country or region (Figure 17; Table 3). They are influenced by investment opportunities which, in many countries, are linked to privatisation plans.

The European Union's FDI positions in the MPC more than trebled between 1996 and 2000. In the latter year, Turkey, Egypt and Morocco alone accounted for nearly 60% of European FDI in the MPC countries\(^{25}\). In absolute terms, the FDI positions in the Maghreb and Mashrek\(^{26}\) countries were almost identical in 2000. But when the size of each country's economy is taken into account (as a percentage of GDP), the presence of European firms is much more noticeable in Maghreb countries, especially Morocco, than in the Mashrek Countries and (Table 3). Among the Member States, the Netherlands, France and Germany were the main providers of FDI in the region. French firms tended to invest in the Maghreb countries, while Dutch and British firms were more likely to invest in the Mashrek countries (Table 3).

### TABLE 3\(^{27}\)

**EU FDI stocks in MPCs in 2000 (EUR mio)**

<table>
<thead>
<tr>
<th></th>
<th>Extra-EU</th>
<th>CC-13</th>
<th>MPC-12</th>
<th>Maghreb</th>
<th>Mashrek</th>
<th>Morocco</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU-15</td>
<td>1517186</td>
<td>75326</td>
<td>22936</td>
<td>6420</td>
<td>5353</td>
<td>3285</td>
</tr>
<tr>
<td>Germany</td>
<td>249647</td>
<td>24095</td>
<td>3138</td>
<td>437</td>
<td>364</td>
<td>212</td>
</tr>
<tr>
<td>France</td>
<td>232815</td>
<td>7607</td>
<td>3626</td>
<td>1711</td>
<td>654</td>
<td>1252</td>
</tr>
<tr>
<td>Italy</td>
<td>67958</td>
<td>4923</td>
<td>2609</td>
<td>903</td>
<td>264</td>
<td>281</td>
</tr>
<tr>
<td>Netherlands</td>
<td>16193</td>
<td>10353</td>
<td>3731</td>
<td>310</td>
<td>1671</td>
<td>81</td>
</tr>
<tr>
<td>Portugal</td>
<td>12064</td>
<td>247</td>
<td>1259</td>
<td>754</td>
<td>504</td>
<td>316</td>
</tr>
<tr>
<td>UK</td>
<td>44286</td>
<td>3967</td>
<td>-</td>
<td>260</td>
<td>1476</td>
<td>74</td>
</tr>
<tr>
<td>Switzerland</td>
<td>127289</td>
<td>-</td>
<td>222</td>
<td>485</td>
<td>193</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>737771</td>
<td>-</td>
<td>10734</td>
<td>2574</td>
<td>2622</td>
<td>39</td>
</tr>
</tbody>
</table>


At around EUR 23 billion, the European Union accounted for more than twice as much FDI in the MPC countries as the United States in 2000. As in the case of the EU, American FDI positions have risen sharply since 1994 but they are still low when compared with other parts of the world, especially South America or Asia. The main destinations for American FDI in the MPC countries were rather Mashrek countries, especially Egypt (Table 3) The EU has traditionally run a large

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26 Egypt, Lebanon, Jordan, Syria and Palestine Authority
27 CC- candidate countries in 2000: Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia and Turkey.
Mashrek: Egypt, Lebanon, Jordan, Syria and Palestine Authority
MPC-12: the 12 Mediterranean Partner Countries

40
FDI surplus with regard to the MPC countries. Direct investment by the MPC countries in Europe in 2000 amounted to EUR 7 237 million (Table 4).

Table 4

<table>
<thead>
<tr>
<th>FDI stocks of MPCs in EU and USA in 2000 (EUR mio)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU-15</td>
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<tr>
<td>MPC-12</td>
</tr>
<tr>
<td>Maghreb</td>
</tr>
<tr>
<td>Mashrek</td>
</tr>
<tr>
<td>Morocco</td>
</tr>
</tbody>
</table>

Throughout recent year, France was a key player in terms of FDI flows to Maghreb (Appendix VI). Out of all EU countries, France had the most stable investment flows whereas Morocco was the main beneficiary. Apart from France, investments above $10 million p.a. were realized by Spain, the Netherlands, the UK, Italy and Germany.

6. EU and EMFTA Initiatives

In 1995, the Barcelona Process marked a decisive date building on enhancing relations between 15 EU member states and 12 Mediterranean Partner Countries (MPC). Through this process, better collaboration in terms of economic sustainability and the creation of “security and shared prosperity” is anticipated. By agreeing on setting up a free trade area in 2010, entitled the Euro-Mediterranean Free-Trade Area (EMFTA), facilitation on interaction and trade is intended between the EU and MPC. In retrospect, academics seemingly agree that the Barcelona Process falls short of delivering its promises. Hence, to date it remains to be seen what and if anticipated economic results can be accomplished and if Mediterranean Partner Countries will benefit eventually. This question is especially of interest and apparent in light of a shift from a sole focus on MPC via the Euro-Mediterranean Partnership (EMP) and the newly set up European Neighbourhood Policy (ENP), including all countries bordering the now enlarged EU.

Firstly, this paper shall elaborate upon recent events that shaped the EU-Mediterranean relations and MPC performance in striving for sustainable economic development, centering its investigation on North African economic features and possible outcomes in light of the ratification of the EMFTA. Subsequently, attention is paid to an assessment of financial and economic factors of the Maghreb countries. Hereby, FDI and import/export performance will be substantial.

28 The EU comprised 15 countries at that time, whereas the Non-European Mediterranean Partner Countries (MPC) included Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia, Turkey, Malta and Cyprus (the latter two are EU members since the EU enlargement on 1.5.2004). Libya has observer status since 1999.

29 The Barcelona Declaration was adopted at the Euro-Mediterranean Conference, 27-28/11/1995. The widest-ranging part of the Work Programme relates to Economic and Financial partnership containing thirteen chapters; the Social, Cultural and Human Affairs section contains eight chapters, while the Political and Security Partnership was the weakest with only three chapters.
Concluding, remarks and recommendations for further cooperation in this indispensable area are systematised.

6.1 Shifting From EMP to ENP
Throughout the now 12 years of continuous efforts between the EU and MPC to foster collaboration and integration, political and economic events altered the relationship of the EMP. External as well as internal events changed the determinants of the partnership and thus had to be included in the adjustment of policy formulations. Before elaborating upon the change from EMP to ENP, however, it is worthwhile to dig into the concepts lying underneath the EMP, consequently understanding its impacts for the ENP, lunched in 2003.

6.1.1 Euro-Mediterranean Partnership
The Euro-Mediterranean Partnership (EMP) was the outcome of the Barcelona Declaration held in 1995, constituting a framework of political, economic and social relations. It manifested intentions to deal with several challenges apparent during these times. Hereby, various determinants lead to focus attention on the Mediterranean Countries. Firstly, close-knit relations had already been established (particularly in trade, e.g. for many MPC the major trading partner is the EU)\(^{30}\), secondly close physical distance with South-European Countries and thirdly a discussion about the North/South divide with its deepening “prosperity gap” advanced political discussion. Further factors were political instability, religious extremism and increasing threats of terrorism. Also population growth with a slacking economy in many MPC furthered young people in the Middle East and North African Region (MENA) to consider emigrating. Consequently the EU experienced mounting immigration pressure. (Gavin, 2005)

Other external forces, such as globalisation and the World Trade Organisation (WTO) pressed towards a further South integration in trade and paved the way to advance Euro-Med relations.

The EMP was perceived as an upgrading of policy to treat the abovementioned challenges and as a concept of development which would allow for North-South-South integration. It was intended not only to integrate MPC through the Euro-Mediterranean Free-Trade Agreement (EMFTA), but also to stimulate South-South integration amongst Mediterranean Partner Countries. This move signified a shift from bilateralism towards a more multilateral form of commitment with and within the MPC. The new region-to-region tactic was established on the idea that a simultaneous two way process of integration would occur. (Gavin, 2005) However, now, after 12 years of “enhanced” relations, it can be stipulated that the EU has pulled the strings and employed a “top-down approach”. The multiregional approach was well intended but positive outcomes are scarce.

\(^{30}\) over 70% of Tunisia’s trade is going to and originating from the EU
Plainly, it can be said that the Barcelona Process did not live up to its expectations in terms of socio-economic progress.

Several aspects can be cited as burden on the process. As Gavin puts forth, facing a highly integrated EU in the North versus fragmentation and internal rivalries in the South, horizontal integration among MPC aimed too high. Additionally, capabilities were scare were experience was needed. “No historical experience of transregional integration [existed] and intra-regional trade was amongst the lowest in the world. Neither was there any institutional framework for regional integration”. (Gavin, 2005) The EMP was essentially a project negotiated and designed within the European Union proposed to the MPC on a basis of “take it or leave it”. (Martin, 2000)

Throughout the years, resistance to democratise augmented from the autocratic elites and religious extremists, which also led to an augmented level of uncertainty and political sensitivity throughout MENA. Certainly, Brussels persistence on political and economic reforms in accordance with liberal-democratic ideals is often translated as interference in the handling of internal affairs and as an attack on the principle of national sovereignty by the Arab governments. (Pollacco, 2006) In 1998 already, Minasi (Minasi, 1998) predicted that the EMP will further bring South-South fragmentation because of its “bi-multilateral” nature.

After shortcomings in MPC development and alterations in determinants contributing to the political agenda, a new policy, including bordering countries of the EU, appeared in 2003. Del Sarto and Schumacher reason that the EMP underwent “reform pressure”, due to external events such as 9/11, the downfall of the peace process in the Middle East and the U.S. invasion in Iraq. Fundamentally, however, was the 2004 EU enlargement, which affected the Southern boundaries, putting forward amendments of the policy towards the EU’s exterior. Concluding, they propose that it was the internal “self-centred” focus that led to a “voluntary” switch from the EMP towards the European Neighbourhood Partnership (ENP).  

6.1.2 European Neighbourhood Partnership

“Wider Europe” was mainly motivated by the EU’s internal dynamics, and not external factors. More specifically, the ENP is a result of the EU’s changed composition and geostrategic outlook in view of the last round of enlargement”.  

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32 Ibid.
Hailed as new approach to “wider Europe”, Romano Prodi declared the European Neighbourhood Partnership (ENP) as tool to maintain and create a “ring of friends”. According to the European Commission, the declared aim of the ENP is to “share the benefits of the EU’s enlargement with neighbouring countries in strengthening stability, security and well-being”. But, due to the enlargement in 2004, not only did the EU turn into a bigger and more powerful entity, its boarder and with it, its focus changed. Considering the regional focus of the EMP, a new policy including all countries bordering the extended EU embraced not only MPC but also e.g. the Balkan states, Belarus and Ukraine. So, what is in for the new and old neighbours? Since no membership in the club of EU members is on offer, other means must be valuable benefits to incorporate the ENP and giving way to reforms. The European Commission put it this way:

Apart from the “traditional” trade preferences and financial assistance, ENP offers:

- gradual participation in agencies and programmes in fields such as education, training and youth, research, environment, culture, audio-visual policy etc.
- the European Neighbourhood and Partnership Instrument (ENPI) – more funding and efficient procedures to support partner countries’ reforms
- new forms of technical assistance
- improved cross-border cooperation along the EU's land and maritime borders
- a long-term goal of a Neighbourhood economic community for partners who are interested and carry out the necessary reforms, with help of EU

Successively, the questions of what such modification - in firstly policy formulation and secondly putting MPC on a par with other bordering countries - could imply for MPC becomes apparent. This will be dealt with in the following section, focusing on benefits and shortcomings of the ENP addressing MPC.

6.1.3 The ENP Applied

Having observed good intentions and shortages of the Barcelona Process, nothing else remains to be done besides evaluating the ENP effect on MENA. Considering the Middle East and North African region it can be argued that the ENP rectifies some shortages of the EMP. Hence, the EU’s policy towards the Mediterranean evokes prospective enhancements, at least in theory. Three issues of considerable meaning are identified.

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33 Romano Prodi (2002): “I want to see a “ring of friends” surrounding the Union and its closest European neighbours, from Morocco to Russia and the Black Sea.” (http://ec.europa.eu)
35 http://ec.europa.eu/world/enp/faq_en.htm
36 based on Del Sarto et. al 2005
1) a bilateral and distinguished approach
2) the principle of “joint ownership”
3) a “carrot and stick sensibility”

Concerning a bilateral and distinguished approach, handling matters on a bilateral and country-to-
country specific approach grants “a far greater opportunity of exerting its political and economic influence in the neighbourhood”, for the EU. (Del Sarto et. al, 2005)

On the other hand, as for the southern partners, the ENP’s bilateral and differentiated focus increases the opportunity of voicing their particular concerns, as it appeared to be a preferential way of negotiating with the EU. Many countries, as e.g. Morocco, Israel and Egypt, “never really appreciated being put into the group of “southern Mediterranean states”, together with real or potential rivals or foes.” (Del Sarto et. al, 2005) In this line, South-South economic integration becomes a remote possibility, if not an impossible one. (Pollacco, 2006)

It may also further dialogue in the Middle Eastern peace-process, uncoupling its success or failure from the future of “regional negotiations” carried throughout the EMP. As Del Sarto et. al stipulate, it needs to be seen how the EU is about to interact with the peacemaking efforts and Israel’s specials standing concerning foreign policy.

Secondly, the principle of “joint ownership” poses a positive development. It seeks to grant ownership of processes to MPC and the EU respectively. This theoretically grants rights and responsibilities to MPC in conjunction with EU member states. Repeatedly, MPC had criticized the lack of adequate consultation and involvement in the formulation of the country-specific priorities of MEDA funding in the framework of the EMP (as argued earlier, the EMP was rather a “top-down pact”). Thus, it specifies the intensive involvement of the partner states in the path to take and in the country-specific definition of priorities, termed “Action Plan”.

Lastly, the “carrot and stick sensibility” approach, or positive conditionality, can further place an improvement to EU-Med relations. The basic idea behind this concept is that reform willing countries (e.g. Morocco) can fast-track through individual relations with the EU. On the contrary, reform-reluctant MPC will not benefit from increased aid or trade concessions.

But taken these three potential positive developments into account, explicit incentives still seem indispensable. So, which incentives is the EU willing - and able - to offer in order to make a difference in the southern Mediterranean? Indeed, the alleged “carrots” that the EU proposes in
order to contribute to socio-economic development and stability in the Mediterranean deserves a more thorough discussion.

Thus, the next section will discuss the “stalemate” that MPC face through on one hand internal but on the other hand regional and EU Association Agreements. To overcome these struggles, the “wider Europe-Neighbourhood” policy thus needs to strengthen the financial dimension of the ENP. One possible move away from financial measures determining the agenda for reforms could signify a further step towards “softer” factors, such as cultural dialogue, education and training, which are urgently needed to foster sustainable economic development in MPC and could grant a more stable base in society. Though, how are agreements currently enacted between the EU and MPC?

6.2. Trade and Integration

6.2.1. Association Agreements

A vital component of the implementation of the MPC has been the implementation of Euro-Mediterranean Association Agreements (AA) between the European Union and nine of its Mediterranean Partners to replace the 1970s Cooperation Agreements. With the conclusion of negotiations with Syria (October 2004), the framework of AA with MPC has been completed. AA are in force between the EU and Tunisia (since 1998), Israel (2000), Morocco (2000), Jordan (2002), Egypt (2004) and on an interim basis with the Palestinian Authority (1997). Agreements were signed with Algeria in December 2001, and with Lebanon in January 2002. Provisions of the AA governing bilateral relations differ from one MPC to the other; as time has gone on more areas of cooperation have been included. Yet several characteristics are communal:

- Political dialogue
- Respect for human rights and democracy
- Establishment of WTO-compatible free trade over a transitional period of up to 12 years
- Provisions relating to intellectual property, services, public procurement, competition rules, state aids and monopolies
- Economic cooperation in a wide range of sectors
- Cooperation relating to social affairs and migration (including re-admission of illegal immigrants)
- Cultural cooperation

37 http://ec.europa.eu/external_relations/euromed/med_ass_agreemnts.htm
38 Ibid
Throughout the years the AA and bilateral negotiations led to the creation of a network of North-South trade agreements, but leaving out institutional enablers for South-South integration. Those institutions were also missing when facilitating investment in the region. Gavin (Gavin, 2005) proclaims that “no institutional provisions for increasing intra-regional trade or attracting foreign direct investments by creating a large regional market have emerged.”

The process to decide on projects and financial assistance was carried out through Country Strategy Papers (CSP). Those, established for the period 2002-2006 were almost solely processed by the EU Commission. “The EU has not involved civil society in the process on the grounds that it was more important to support civil society through technical assistance to make it stronger before it could be accepted as an actor in the negotiating process. The unilateral nature of decision-making on financial and technical assistance makes this a donor dominated rather than a mutually agreed development instrument.”

Nowadays, those CSP are substituted by Action Plans, identified on a country specific level inside the ENP framework. Those Action Plans “ensure that both the EU and its partners take full advantage of the trade provisions in existing bilateral agreements by ensuring their full implementation and taking account of regional initiatives.”

The European Commission perceives potential in the market opening in line with WTO principles, deeper liberalisation and regional integration. A removal of non-tariff barriers to trade through convergence of legislative and regulatory frameworks in crucial sectors such as intellectual property rights is emphasised. Furthermore, by establishing transparency, predictability, and simplification of ENP countries’ rules the investment climate could be enhanced. Summing up: good advice and a long way to go. But, what directions are taken?

40 http://ec.europa.eu/external_relations/euromed/med_ass_agreemnts.htm
41 “Strengthening the ENP” Communication. Finches on Sectors. 2002
42 Ibid
6.2.2. The Euro-Mediterranean Free Trade Agreement

As the European Mediterranean Free-Trade Area (EMFTA) is about to be enacted in the near future\textsuperscript{43}, one might emphasise its impact on the EU, its neighbouring countries, partners, and it affecting various aspects such as politics, economics, environmental, social and cultural determinants.

This final chapter will argue that the EMFTA in its current configuration is not sustainable. It is essential to find a critical and progressive approach to establish Europe’s legitimacy and believe in its success, as a project taking into consideration its contextual particularity. This is chiefly valid when reviewing those fundamental changes that firstly lead to the EMP and secondly altered the approach to set up the ENP. Seconding that, Attinà and Rossi (2004) declare that “a step-by-step or progressive approach towards EU neighbouring countries is required in order to introduce a gradual engagement for each state depending on its willingness to progress with economic and political reform.” Employing a top-down approach and controlling progress does not lead to a natural upgrading conform to contextual settings.

To establish a remark, financial data will be used to examine the economic factors influencing and driving MPC as well as to ascertain their role in the EMFTA. Firstly, export and import performance of MPC will be analysed while ultimately scrutinizing FDI in and outflows.

The EMFTA as such has to be put into context where Euro-Mediterranean Association Agreements are the integral legal framework negotiated between the European Union and 9 of the 12 Mediterranean Partners, together with Free Trade Agreements between the Mediterranean Partners themselves. For Turkey, Cyprus and Malta, relations were governed by pre-existing Association Agreements providing inter alia for the progressive establishment of customs unions. Nowadays, Malta and Cyprus have joined the EU and even became member of the Euro. Grasping the European Economic Area, the Central and Eastern European Countries and the EMFTA Partners, this free trade zone could eventually include some 40 States and 600-800 million consumers rendering it one of the world’s most important trade entities. (European Commission, 2003). But, before this date approaches many battles still need to be fought. As demonstrated in section 2 several events lead to the creation of a common policy for the MPC. Thus, single future agreements depend on internal and external factors, sometimes even far-reaching single events such as 9/11, are leading to partially unforeseen constellations. Those, consequently, give way to fresh thoughts and adaptations in external policy formulation. For instance, the recent EU-Africa summit in Portugal (Dec. 2007) showed how deep gaps between

\textsuperscript{43} The Barcelona Declaration puts forth 2010 as date, but recent appraisals of economic, social and political factors in MPC beg for a re-evaluation and probable postponement.
EU and some African states are. Furthermore, France’s newly elected president Sarkozy, in his solo attempt to solve the “Bulgarian nurses affair” and later on selling nuclear power to Libya’s leader Gaddafi, is a clear indication of the non-existing common EU foreign policy. On the other hand, he is advocating the creation of a Mediterranean Bloc quite energetically which could lead to a new wave of engagement with and in the region. Another interesting internal development is, at last, the EU treaty (the Treaty of Lisbon), which was agreed upon throughout the Portuguese EU presidency. This could imply more coherence in the EU’s action towards the outer world.

6.2.3. The Role of (Free-) Trade

Free-Trade and particularly Foreign Direct Investments are deemed paramount to MPC. The EMP included relatively minor considerations in regards to FDI, whereas through the later process and AA, MPC realized that FDI is an option to foster economic performance and to counterbalance initial displacement costs and budget constraints.

According to trade literature a country performs in relation with the products it produces. Hereby, more variety in the product portfolio signifies broader chances to trade and benefit from agreements with other nations. As the World Bank (2006) puts it, “a likely success (or failure) of regional trade agreements is partly contingent on the range of products that prospective members have the capacity to export. If the members export a wide range of diversified goods, this is a positive factor.”

If, by contrast, exports are highly concentrated, regional trade may be burdened. The underlying assumption is that the higher the level of export diversification, the better the prospects for a successful regional trade agreement. The more diversified a country’s exports the greater the range of potential products that can be traded with regional partners. If only a limited number of such goods exist, prospective members of a Regional Trade Agreement (RTA) may have to rely heavily on third countries for a higher share of its key imports and as a destination for their key exports, and this would be likely to reduce their commitment to the RTA. (Yeats, 1998)

Another factor of export concentration is the question of stability. Some studies show that countries with highly concentrated exports may experience a relatively high degree of export earnings instability – a factor that makes economic planning difficult. Such unsteadiness could encumber a country’s ability to consistently preserve financial commitments required by a regional arrangement.

Examining Maghreb countries, the World Bank (WorldBank, 2006) denotes that Maghreb countries export a low range of products compared with other regional groupings, although they have increased product variety over time. Maghreb exports seem to be confined to a few products that is, a small number of products seem to accumulate a significant share of export revenues. Maghreb’s average range of products exported in 2004 was 100, half the range of products exported by other regional trading blocs. NAFTA and EU15 exported over 220 items in 2004. Eastern European Countries and ASEAN countries also doubled the Maghreb countries in the range of products exported in 2004. (WorldBank, 2006)

The regional average masks differences among Maghreb countries. Looking at more disaggregated country data over recent years, the picture is slightly more encouraging. Tunisia and Morocco increased average product variety from about 100 to over 150 over the period 1980-2004.

Tunisia and Morocco’s exports are still dominated by textiles and apparel. Most exporters specialize in subcontracting and process imported inputs. For Algeria, fuels are by far the largest product group in its export bundle. High market and product concentration are clearly a source of vulnerability for Maghreb exports and play against future prospects for regional merchandise trade integration. Despite this, especially since the 1990s, Morocco and Tunisia have shown some signs of diversification. Tunisia and Morocco managed to bring the product concentration index to a level percent and 20 percent lower, respectively, in 2004 that the one that existed in 1980.

In regards to assessing possible gains of losses derived from the EMFTA, it is essential to examine key variables impacting on the success or failure. Tovias (Tovias, 1997) elaborates on the degree of openness of MENA countries, the level of tariffs (most-favoured nation), fiscal revenues drawn from international trade taxes and the actual contents of the agreements. As the AA have been dealt with already, imports and exports are used to exhibit the degree of openness while furthermore tariffs and fiscal revenues will give insight into economical performance of the MPC, to finally appraise the likely impact of the EMFTA on MPC.

6.2.3.1. Exports

Considering data from 1993, it appears that MPC are highly engaged with EU countries (except in the case of Jordan), exporting more than a third of their shipments to the EU and reaching two-thirds or more in the case of Algeria, Morocco and Tunisia. One the other hand, the share of other MPC exporting to other MPC is almost negligible in some cases. Figures range from 18.0 percent in Syria down to 0.9 in Israel. Since Syria, Egypt and Jordan are the only countries with two digit percentages, this leads to conclude that not much interregional export trade is taking place. Also
the relatively small share in interregional trade of more developed countries like Israel (0.9%),
Morocco (6.2%), Tunisia (9.6%) and Turkey (7.3%) fits this picture.

Table 5 Exports of Selected MPC (1993 and 2004)\textsuperscript{46} in % of total Exports

<table>
<thead>
<tr>
<th></th>
<th>Alg 93</th>
<th>Egy 04</th>
<th>Isr 93</th>
<th>Jor 04</th>
<th>Mor 93</th>
<th>Syr 04</th>
<th>Tur 93</th>
<th>Tun 04</th>
</tr>
</thead>
<tbody>
<tr>
<td>To EU</td>
<td>67.6</td>
<td>54.0</td>
<td>45.9</td>
<td>29.6</td>
<td>34.8</td>
<td>6.6</td>
<td>3.2</td>
<td>6.6</td>
</tr>
<tr>
<td>To other MPC</td>
<td>1.7</td>
<td>6.9</td>
<td>5.5</td>
<td>13.6</td>
<td>0.9</td>
<td>2.6</td>
<td>8.6</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Table I indicates data of the MENA region, its export patterns with the EU and among its region.

When focusing on the development of exports throughout the years from 1993-2004, a decrease in exports from the EU becomes apparent (except Morocco, Tunisia and Turkey). At the same time, all countries engage in more intra-regional trade with the other MEDA countries (except again Morocco, Tunisia and Turkey). In the case of Morocco and Tunisia, a quite strong dependency in trade patterns can be displayed. Having reached 74.4% and 83.3% (in 2004) respectively, signifies strong ties with the EU and dependency.

Highlighting Maghreb countries, the World Bank (World Bank, 2006) describes a high degree of market concentration with the European Union as the most important trading partner. The geographic destination of trade for the Maghreb region is driven significantly by proximity. The EU is the main source of exports and import destination for the Maghreb countries, constituting over 65 percent of total trade by 2004 while the share of exports going to the EU is 70 percent. The high market concentration points to the vulnerability of the Maghreb region to changes in European market access conditions. Maghreb exports to other MENA countries as a share of total exports from the Maghreb increased from 2 percent in the 1980s to 3 percent in 2004 while the import share expanded from 5 percent in the 1980s to 6 percent by 2004.

Another way to look at it is regarding different product breakdowns. Certainly, if exports are higher than imports, the balance of payments of this respective country will most likely benefit. So does selling more goods and services overseas – a rise in exports – boosts national income and should have a positive multiplier effect on output, national income and employment. This however is not the case for the majority of MPC.\textsuperscript{47} Additionally, the sort of export which is delivered to other parties can alter an economy drastically. By and large, it is argued that bundled exports in just a few goods and industries (e.g. oil, gas and resources) are not as sustainable as a wider export

\textsuperscript{46} Ibid and data for 2004 from Euro-Mediterranean Statistics, 2006 edition. Lebanon and West Bank and Gaza strip are excluded due to lack of data. This fact slightly affects trade with other MPC 2004 data, but rather marginally since imports and export rates are among the lowest.

\textsuperscript{47} Especially Algeria pose a variation, which will be discussed in short
portfolio including various types of goods. Countries that have abundant supply of one resource could even get locked into an "export dependency".

Considering the product breakdown (Appendix I), six main categories of products are listed. These range from food to machinery and all have a distinctive industry behind them. One realisation is that the total value of products to North Africa is about 60% of the total exports from Africa. From these 60%, close to everything originates from Morocco, Algeria, Egypt, Tunisia and Libya. However, within these five states, huge differences exist. To summarize, Libya and Algeria export the bulk of products (about 65%) to the EU. Interestingly, these consist mainly (in the case of Libya solely) of energy resources. machinery, manufacturing goods and chemicals are on the “shopping list” of MPC. Yet, Libya is lacking behind in purchasing power. Other exports such as machinery, food and raw materials are basically non-existent. One the other hand, Morocco, Tunisia and to lesser extend Egypt, portrait a more balanced export portfolio, where machinery, manufacturing goods and also food (in the case of Morocco) add up to their economic performance. Generally speaking, however, exports of the region are small, non-dynamic, and poorly diversified. (Müller-Jensch, 2005).

Now, having displayed some particularities of MPC regarding exports, one has to consider the other side of the coin and review imports and specifically what sort of imports are demanded by MPC.

6.2.3.2. Imports

Considering data from 1993 again, it appears that the MPC are highly import dependent on the EU, with more than a third of their imports coming from there and reaching two-thirds or more in the case of Algeria and Tunisia. One the other hand, the share of other MPC importing from other MPC is almost negligible in some cases. From 11.0 percent in Jordan down to 0.5 in Israel leads to conclude that not much interregional trade is taking place. Also the small share of Turkey (2.8%) and Egypt (1.9%) add to this picture.

Table 6 Imports of Selected MPC (1993 and 2004) in % of total Imports

<table>
<thead>
<tr>
<th></th>
<th>Alg</th>
<th>Egy</th>
<th>Isr</th>
<th>Jor</th>
<th>Mor</th>
<th>Syr</th>
<th>Tur</th>
<th>Tun</th>
</tr>
</thead>
<tbody>
<tr>
<td>From</td>
<td>EU</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>93 04</td>
<td>65.7</td>
<td>54.8</td>
<td>39.0</td>
<td>26.6</td>
<td>49.2</td>
<td>41.0</td>
<td>34.8</td>
<td>58.8</td>
</tr>
<tr>
<td>93 04</td>
<td>58.8</td>
<td>41.0</td>
<td>49.2</td>
<td>34.8</td>
<td>23.6</td>
<td>34.8</td>
<td>56.1</td>
<td>56.1</td>
</tr>
<tr>
<td>From</td>
<td>other</td>
<td>MPC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.3</td>
<td>5.8</td>
<td>1.9</td>
<td>7.4</td>
<td>0.5</td>
<td>3.0</td>
<td>11.0</td>
<td>11.5</td>
<td>4.5</td>
</tr>
<tr>
<td>9.3</td>
<td>10.6</td>
<td>2.8</td>
<td>3.0</td>
<td>4.4</td>
<td>4.3</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

When focusing on the development of imports throughout the years from 1993-2004, a decrease in imports from the EU becomes apparent (except in the case of Turkey). At the same time, just a
few countries engage in more intra-regional trade with the other MEDA countries. (Egypt and Israel increased its trade, but 7.4% or 3% respectively is still very low). Thus it can be concluded that the EU stake in imports to the MEDA has decreased, which can be interpreted as beneficial, since imports from various “parties” can spread risk and diversify investments. Bluntly put, MEDA is decreasing its dependency from the EU. This is, however, simplistic and a narrow look has to be taken on what sort of imports and exports are sought after by MEDA countries.

Taking into account the product breakdown (Appendix II), the six main categories of products are listed again. One realisation is that the total value of products to North Africa is about 45% of the total imports from Africa. From these 45%, close to everything goes to Morocco, Algeria, Egypt, Tunisia and Libya. However, within these five states, drastic differences persist. Above all machinery, manufacturing goods and chemicals are on the “shopping list” of MPC. Yet, Libya is lacking behind in purchasing power, concerning EU trade. That these imports and exports are a vital source of income or consumption for a country’s citizen is granted. If problematic trade terms exist for certain industries, countries can engage in protectionist behavior and establish or heighten tariffs or quotas. These are also a vital source of income for the state, but shall be progressively abandoned through the ratification of the EMFTA. In the next chapter tariffs and fiscal revenues of MPC are scrutinized to ascertain their momentum.

6.3 Policy Reform and Regulation through Tariffs

Bearing in mind the development of free trade in the Mediterranean Area through EMFTA directives, tariff and non-tariff barriers to trade in manufactured products will be progressively eliminated in accordance with timetables to be negotiated between the EU and MPC. Taking as a starting point traditional trade flows, and as far as the various agricultural policies allow and with due respect to the results achieved within the WTO negotiations, trade in agricultural products will be progressively liberalised through reciprocal preferential access among the parties. Trade in services including right of establishment will also be progressively liberalised having due regard to the GATS agreement. Dismantling customs duties requires substantial reforms of fiscal, economic and industrial sectors. In this context, the MEDA was, and the ENPI will be a programme providing support to economic reforms in the public and private sector, keeping sustainable development in mind. (European Commission, 2003)

But, as can be seen in Appendix III, trade barriers still exist, as do tariffs. More generally, taking average tariffs to exemplify current trade procedures, some points can be established: Considering the recent findings of the World Banks’ (WB) Economic Development Prospects, it can be noted that “relative to the world, tariff reform by MENA since 2000 ranks on average in the

top [...], higher than any other region but Europe and Central Asia.” Herein, the region’s resource-poor countries, e.g. Egypt (9.1%), Jordan (11.8%), and Lebanon (5.4%) performed “best” on average. (World Bank, 2007) (Appendix III)

On the other hand, even though tariff reforms are underway and progress is perceptible, the region as such lacks behind in the creation of “an environment conducive for trade remains far from complete.” Putting the level of tariffs into a broader picture, thus benchmarking the tariff protection with other regions, an average of 13.1 percent signifies a figure, higher than all other regions but South Asia and Sub-Saharan Africa, and far higher than the world average of 9.8 percent (Appendix III). In both Tunisia and Morocco, the current simple average tariff is above 26 percent, and the heavy tariff protection of the domestic market has changed only slightly in the course of the past 10 years. Other nations, such as Algeria and Libya endorse high tariffs 18.7 percent and 17 percent correspondingly. (World Bank, 2007) Even though progressive changes have been enacted through reforms, governments in this region seem to be somewhat reluctant to opening up their boarders to free trade completely. Furthermore, due to specific duties or taxes based on volume, instead of import value, as well as extra import clearance procedures, trade in imports is cumbersome.

According to a study of the World Bank (World Bank, 2006), Maghreb countries made progress in tariff reform over the past few years. So did Morocco reduced MFN tariffs to a maximum of 10 percent for goods freely traded with the EU in 2004. The reform progress made by the Maghreb compares the average tariffs worldwide in 2004 with those in 2000. From this study, the World Bank denotes clarity that Maghreb countries have managed to reduce trade tariffs since 2000.

However, despite further tariff reductions, the Maghreb countries are still highly protected. Despite the trade liberalization efforts and the recent signs of dynamism of Tunisian and Moroccan exports, their penetration into external markets has merely kept pace with the world’s increase in exports. This recent export performance masks export vulnerabilities that result from still-high trade protectionism, as evidenced by the high level of the region’s simple average of most-favoured nation (MFN) tariffs. This protective blanket has converted the Maghreb countries into one of the ten most highly protected regional markets in the world. This high level of protection, the World Bank reasons, is a legacy of the import-substitution strategy pursued following independence in Maghreb states which reduces firms’ incentive to trade, since their profits often are higher in sheltered markets. In other words, high transaction costs occur.

In Morocco, the high level and dispersion of multilateral tariffs is still a concern. Morocco grants at least MFN treatment to all its trade partners. Since the end of the Uruguay Round of multilateral trade negotiations in 1995, Morocco has bound all its duties to rates ranging from 0 to 380
percent. According to a study, the simple average external tariff amounted to 30 percent (50.6 percent for agricultural products and 26 percent for manufactures) in 2004. Morocco’s tariff structure is in general escalatory, such that import duties on raw materials are lower than those on semi-processed products, which in turn are lower than the tariffs on finished goods (World Bank, 2005). Many of Morocco’s tariffs are regarded as very restrictive, so that little trade in the respective tariff lines occurs. Thus, the trade-weighted average of MFN import duties is at 23.5 percent, considerably lower than the simple average.

In Tunisia, the simple average tariff was 32 percent in 2004 (with the average duty on agricultural products being 69 percent; and 23 percent for non-agricultural products). The trade-weighted rate is still at almost 23 percent for all goods (20 percent for industrial products and 42 percent for agricultural products). Overall, the tariff structure in Tunisia is characterized by mixed escalation, with raw materials protected by average rates much higher than those for other categories of products.

In Algeria, the simple average external tariff is lower than in Morocco and Tunisia amounting to 18.7 percent in 2004 (with the average duty on percent for agriculture products being 23 percent and 18.1 percent for non-agricultural products).49

7 Conclusions

Due to recent changes in trade and investment policies between the EU and Maghreb, an investigation of FDI was deemed essential to shed light on the rather poor performance of MENA countries and North Africa in particular. Throughout this study, several aspects of Maghreb countries were portrait while particular focus was placed on the interlinkage between macroeconomic policies and FDI.

As research topic, the Mediterranean area is a hot spot where socio-political tensions exist and limited knowledge about governance, investment policies and related trade regimes is available. To analyse the chosen region, the thesis is built on a country-based methodology and follows a macro-level approach analyzing FDI flows to answer the research questions.

In many ways have investment policies and trade patterns affected FDI. Those initial agreements in Barcelona in 1995, sparked little by little reforms in Maghreb countries. Even though Maghreb countries may still be regarded as highly protected, more trade and FDI flows are obvious. Comparing the three countries, Algeria appears to be the least diversified in terms of trade and

49 WorldBank, 2007
FDI. Morocco and Tunisia trade with a broader base of EU members and offer more variations for investments. However, a high dependency on Europe’s progression (France in particular) illustrate that this can only be the beginning of a deeper global integration. To climb up the stages of the IDP (from 2 to 3), a stronger business economic base has to be established so that more stable outflows and inflows emerge.
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### Annex

#### Appendix I: Product Breakdown of EU25 Trade by main Partner Country – Exports of MPC 2006

*Value (Million Euro) and variations (%)*

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Food beverages and tobacco</th>
<th>Raw Materials</th>
<th>Energy</th>
<th>Chemical Products</th>
<th>Machinery and transport equipment</th>
<th>Miscellaneous Manufacturing Goods</th>
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</thead>
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<tr>
<td><strong>Value 06/05</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Africa</td>
<td>123,961</td>
<td>13.5</td>
<td>10,575</td>
<td>-0.9</td>
<td>7,162</td>
<td>17.7</td>
<td>64,433</td>
</tr>
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<td></td>
<td>7,162</td>
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<td>North Africa</td>
<td>72,084</td>
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<td>2,262</td>
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<td>1,690</td>
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Appendix II: Product Breakdown of EU25 Trade by main Partner Country – Imports of MPC 2006

Value (Million. Euro) and variations (%)

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<th>Food beverages and tobacco</th>
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<th>Energy</th>
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### Appendix III

#### Table 3.4: Tariffs and duties in the region, 2006

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<th>Non ad valorem duties</th>
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### Appendix IV

**FDI Outward and Inward Stocks & Flows according to region, from 1980-2006**

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| Source: UNCTAD FDI database |
Appendix V

Scattered Diagrams of the three Maghreb countries (NOP) positioning

(Source: Foreign Direct Investment and Development in MENA Countries, Anil Divarcy, Mehtap Hisarcyklylar, Ozgur Kayalica, and Saime Kayam)

Appendix VI

VI A: FDI flows in host economy, by geographical origin, 1998-2001
(Millions of dollars)

<table>
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<th>2001</th>
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Source: UNCTAD WID Country Profile: ALGERIA
VI B: FDI flows in host economy, by geographical origin, 1996-2004
(Millions of dirhams)

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Source: UNCTAD WID Country Profile: Morocco

VI C: FDI flows in host economy, by geographical origin, 1990-2003
(Millions of dollars)

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Source: UNCTAD WID Country Profile: Tunisia
Executive Summary

The purpose of this paper was to exhibit characteristics of Maghreb countries. Since recent changes in trade and investment policies between the EU and Maghreb occurred (particularly by setting up the Barcelona Process in 1995), an investigation of FDI was deemed essential to shed light on the rather poor performance of MENA countries and North Africa in particular. Throughout this study, several aspects of Maghreb countries were portrait while particular focus was placed on the interlinkage between macro economic policies and FDI.

While gathering data on Maghreb countries, the “progression” of the EMFTA leading to a bonding of the EU and Maghreb countries called for further exhibition in terms of FDI patterns. Thus, this paper originates out of a set of data and follows an inductive approach which maps out relationships between theoretical concepts and then moves towards concrete empirical evidence to confirm or refute theory. Secondary data is also the main source of information for the theoretical part of this study and for data on the country profiles. I used both the internet and the library to review relevant articles and books. Numbers on FDI in- and outflows presented were previously compiled by professionals such as industry organizations, well-established international organizations acting as an information service for governments and industry, national banks and non-governmental bodies.

After having discussed the Transaction Cost Theory, Resource Based Theory, Relational View and Network Perspective in depth, the theoretical discussion embarked on relating those “classic” theories to the OLI and Investment Development Path. After walking the reader through the stages of the IDP an own framework is constructed to exhibit macro economic policy formulations and the dynamics of EU-Maghreb relations. Consequently, and to analyse the chosen region, the thesis is built on a country-based methodology and follows a macro-level approach analyzing FDI flows.

The following section applies the propositions put forward in my own framework to the case countries. In order to understand the dynamics and current challenges of the Maghreb countries, a case approach is employed. Thus, this section starts with a presentation of the current political agenda surrounding and influencing Maghreb countries. Subsequently, motivations for trade and potential integration are examined while trends of nation-wide policy formulations are compared. Later on, a narrow investigation of factor endowments and trade patterns of important industries of Maghreb depict locational settings while keeping key investors in mind. Concluding, those factors are tested against my suggestions in a comparative analysis, before a detailed positioning of
Maghreb counties, as regarded via the Investment Development Path, takes place. This will eventually answer the research question about delicate Maghreb FDI patterns.

In many ways do investment policies and trade patterns affect FDI. Those initial agreements in Barcelona in 1995 sparked little by little reforms in Maghreb countries. Even though Maghreb countries may still be regarded as highly protected, more trade and FDI flows are obvious. Comparing the three countries, Algeria appears to be the least diversified in terms of trade and FDI. Morocco and Tunisia trade with a broader base of EU members and offer more variations for investments. However, a high dependency on Europe’s progression (France in particular) illustrate that this can only be the beginning of a deeper global integration. To climb up the stages of the IDP (from 2 to 3), a stronger business economic base has to be established so that more stable outflows and inflows emerge.