BOX 2.4.1 Recent investment slowdown: Middle East and North Africa

Severe terms-of-trade deteriorations and uncertainty associated with deep political changes have weighed on investment in the region. Investment growth slowed from 4.4 percent in 2010 to 2.6 percent in 2015. Investment needs remain sizable in non-Gulf Cooperation Council EMDEs in the region, especially in transport and energy infrastructure.

The Middle East and North Africa (MNA) accounted for 4 percent of global investment, on average, during 2010–15.[1] Investment growth in the region slowed from 4.4 percent in 2010 to 2.6 percent in 2015, far below the long-term (1990–2008) average of 7.2 percent, with considerable divergence among oil exporters and importers (Figure 2.4.1.1).

This box discusses the following questions:

- How has investment growth in the region evolved?
- What were the main sources of the investment slowdown?
- What are the remaining investment needs?
- Which policies can help address investment needs?

The Box documents the recent slowdown in investment growth in the Middle East and North Africa due to the severe terms-of-trade deteriorations in oil-exporting economies and uncertainty associated with deep political changes in several oil-importing economies. Remaining investment needs are sizable, especially in the transport and energy sectors.

How has investment growth in the region evolved?

In 2015, investment growth remained below its long-term average in 70 percent of EMDEs in the region, and investment contracted 30 percent of the EMDEs in the region. However, investment developments have diverged between oil exporters and oil importers since the broad-based slowdown in investment growth during 2010–13.

Investment growth in oil-exporting economies has evolved in line with oil prices, which rose rapidly in 2010 and 2011. When the steep oil price decline began in mid-2014, governments initially responded with additional fiscal stimulus, often in the form of public investment. As a result, investment growth in oil-exporting economies rose more than 3 percentage points in 2014, to 7.3 percent. Yet, sharp oil revenue losses and fiscal constraints brought project delays and cancellations in 2015. Investment growth fell to an average of 2.4 percent in 2015, the slowest pace since 1994, and investment contracted in three of the four largest oil-exporting economies in the region (Algeria, Islamic Republic of Iran, and Saudi Arabia). Preliminary data suggest further contraction in investment in 2016 in oil-exporting economies. For example, Saudi Arabia, the largest economy in the region, experienced a 16 percent year-on-year contraction in the first half of the year.

Among oil-importing countries, investment growth decelerated sharply in 2011, to 0.2 percent, when mounting political tensions during the Arab Spring were rapidly followed by an intensifying Euro Area sovereign debt crisis. The sharp recovery of investment growth in 2015, to 4.0 percent, reflected efforts to address infrastructure needs in the Arab Republic of Egypt and Morocco, the two largest oil-importing economies in the region, while investment contracted in several smaller oil importers (Jordan, Lebanon, Tunisia). The private sector contributed more strongly than the public sector to investment growth in Egypt, a typical pattern among oil importers. Even with the recovery in 2015, investment growth in oil-importing countries was still below the long-term average of 5.1 percent. Heightened balance of payments and fiscal pressures in Egypt were likely accompanied by weaker investment growth in 2016. Recently-implemented structural reforms and expansionary policy among oil-importing countries may lift investment in the medium term, however (IMF 2016p).

What were the main sources of the investment slowdown?

A severe terms-of-trade deterioration in oil exporters, far-reaching political changes, and spillovers from armed conflict in several countries in the region weighed heavily on activity and sentiment. As growth prospects dimmed, especially among oil-exporting countries, investment growth slowed sharply across the region.

Oil-exporting countries—where oil and gas accounts for, on average, 40 percent of GDP, 70 percent of fiscal revenues, and 80 percent of goods exports—have been

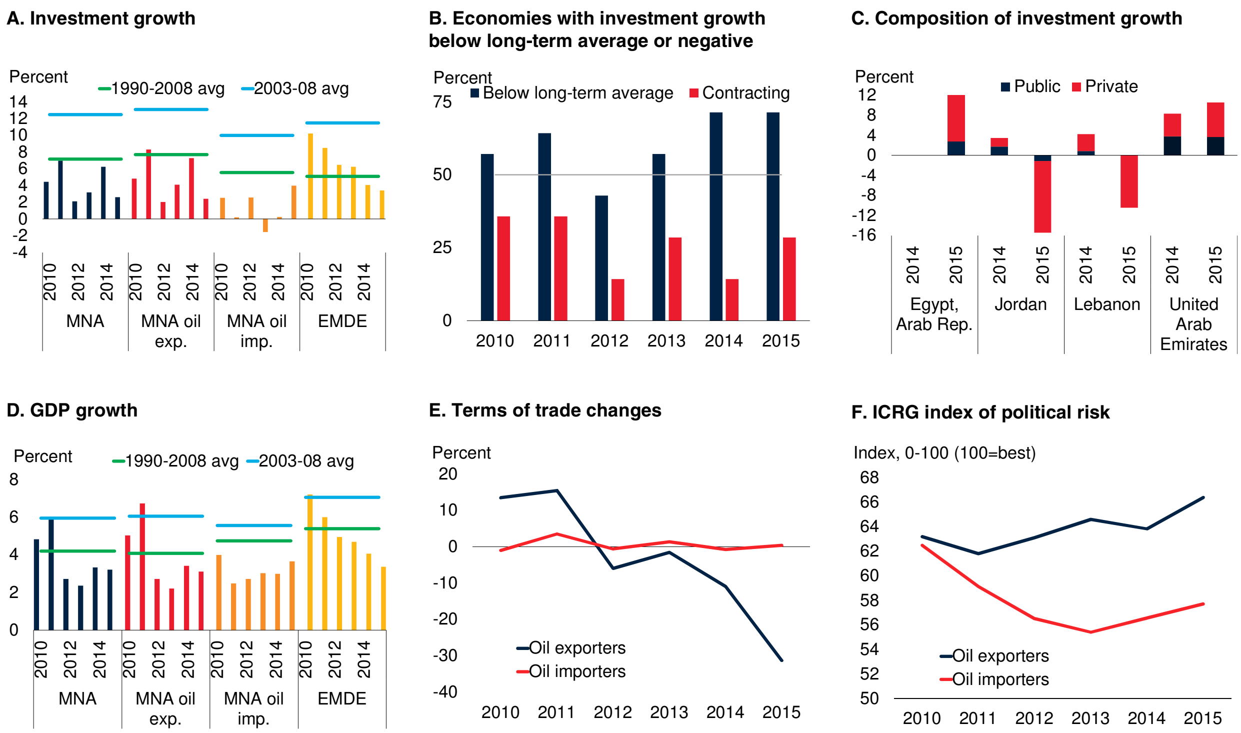
Note: This box was prepared by Dana Vorisek.

[1] Throughout this box, unless otherwise specified, investment refers to real gross fixed capital formation (public and private combined). For the sake of brevity, "investment" is understood to indicate investment levels. Investment growth is measured as the annual percent change in real investment.

BOX 2.4.1 Recent investment slowdown: Middle East and North Africa *(continued)*

FIGURE 2.4.1.1 Investment growth slowdown

Investment growth slowed from 4.2 percent in 2010 to 0.5 percent in 2015. The slowdown reflects a severe terms of trade deterioration in oil exporters, spillovers from armed conflict, and worsening political uncertainty in oil importers.



Sources: Haver Analytics, Political Risk Services Group (PRS), World Bank.
A. Averages weighted by investment levels. Oil exporters include Algeria, Bahrain, the Islamic Republic of Iran, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates. Oil importers included Djibouti, Egypt, Jordan, Lebanon, Morocco, and Tunisia. "EMDE" is emerging market and developing economies.
B. Economy coverage is the same as for panel A.
C. Figure shows growth rates of gross fixed capital formation in constant 2010 U.S. dollars.
D. Averages weighted by GDP levels. Oil exporters include Algeria, Bahrain, the Islamic Republic of Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Oil importers include Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank and Gaza.
E. Investment-weighted averages. Oil exporters include Algeria, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates. Oil importers include Egypt, Jordan, Lebanon, Morocco, and Tunisia.
F. ICRG is the International Country Risk Guide, produced by the PRS Group. Chart shows investment-weighted averages of country-specific political risk indexes in the ICRG. An increase denotes greater political stability. Oil exporters include Algeria, the Islamic Republic of Iran, Iraq, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates. Oil importers include Egypt, Jordan, Lebanon, Morocco, and Tunisia.

hard-hit by the sharp oil price decline since mid-2014. The terms of trade of oil exporters in the region deteriorated sharply between 2011 and 2015. Panel regression estimates suggest that the terms-of-trade shock accounted for nearly all of the slowdown in investment growth (Chapter 3). A two-year growth contraction in the Islamic Republic of Iran in 2013 and 2014 also contributed to the slowdown.

In oil importers, deepening political uncertainty associated with profound institutional changes in 2011 weighed heavily on investment. Political risk deteriorated particularly sharply in Egypt and Tunisia, where civil uprisings led to regime change, and has not yet recovered to 2010 levels. Developments in the larger economies in the region had spillovers to confidence in the smaller ones (World Bank 2015r). On average, such political uncertainty may have been associated with slower investment growth of approximately 1.5 percentage points during 2011–15 (see Chapter 3).

What are the remaining investment needs?

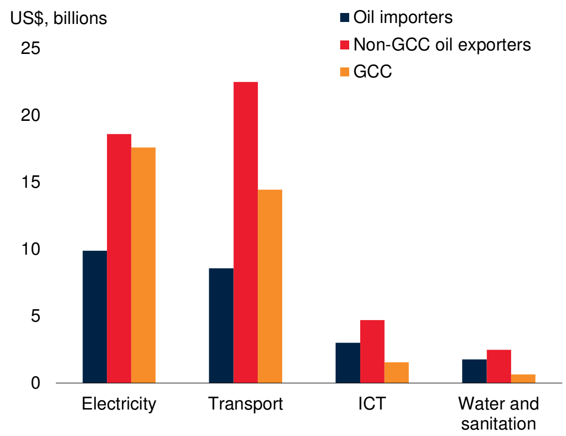
A ramping up of infrastructure investment is needed across MNA (Figure 2.4.1.2). In oil-importing and non-GCC oil-exporting countries, where the quality of infrastructure is on par with that in all EMDEs, there is significant underinvestment in the transport (in particular, roads) and electricity sectors. In Lebanon, frequent blackouts make

BOX 2.4.1 Recent investment slowdown: Middle East and North Africa *(continued)*

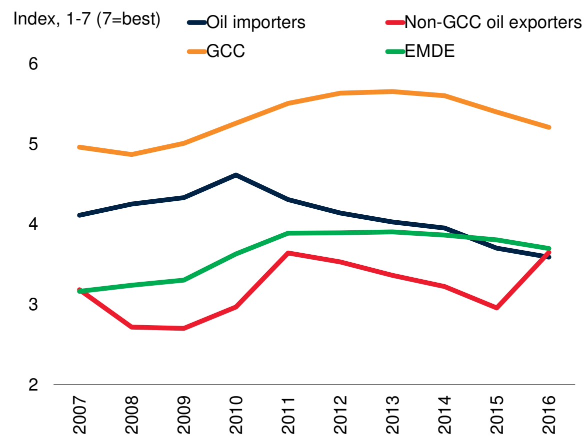
FIGURE 2.4.1.2 Infrastructure, health, and education indicators

Infrastructure investment needs are high, especially in electricity and transport. While the Middle East and North Africa performs well relative to other EMDEs on basic health measures, it is at or below the EMDE average in terms of education indicators, despite considerable long-term gains.

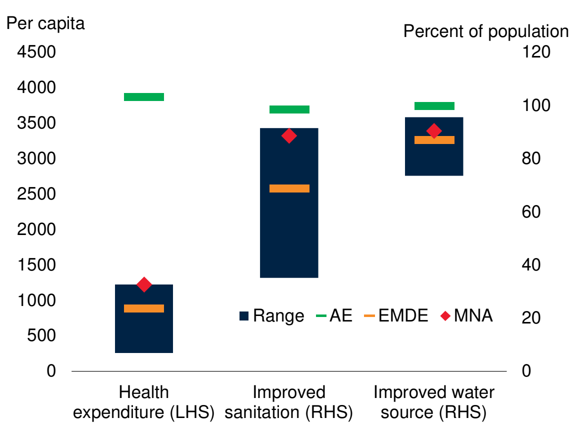
A. Infrastructure investment needs



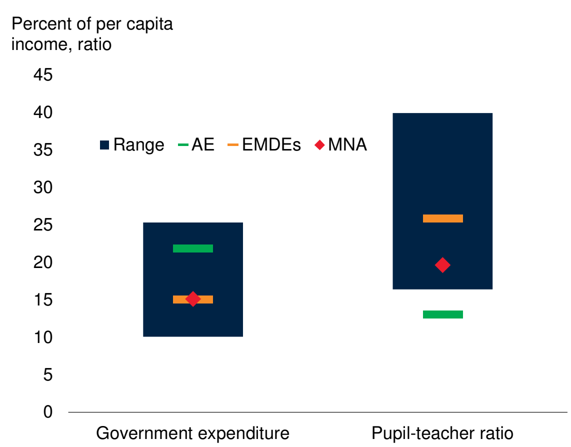
B. Quality of infrastructure



C. Selected health care indicators



D. Selected education indicators



Sources: Estache et al. (2013), World Economic Forum Global Competitiveness Index, World Bank.

A. Values are constant 2005 U.S. dollars and indicate annual investment needs for 2011-20. Oil importers include Djibouti, Egypt, Jordan, Lebanon, Morocco, and Tunisia. Non-GCC oil exporters include Algeria, the Islamic Republic of Iran, Iraq, Libya, Syria, and the Republic of Yemen. Gulf Cooperation Council (GCC) countries include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

B. Unweighted averages of survey data. Data was collected using the question: "How would you assess general infrastructure (e.g., transport, telephony, energy) in your country? (1 = extremely underdeveloped—among the worst in the world; 7 = extensive and efficient—among the best in the world)." Oil importers include Egypt, Jordan, Lebanon, Morocco, and Tunisia. Non-GCC oil exporters include Algeria, the Islamic Republic of Iran, Libya, and the Republic of Yemen. GCC countries include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

C. Blue bars denote range of unweighted regional averages across EMDE regions. Health expenditure per capita in purchasing power parity terms, unweighted averages of 199 EMDEs, 34 AEs, and 17 MNA economies. Access to improved sanitation facilities (in percent of population), unweighted averages for 150 EMDEs, 33 AEs, and 19 MNA economies. Access to improved water sources (in percent of population), unweighted averages for 148 EMDEs, 34 AEs, and 18 MNA economies. Latest available data available during 2011-15.

D. Blue bars denote range of unweighted regional averages across EMDE regions. Government expenditure per primary student (in percent of per capita income), unweighted averages of 87 EMDEs, 32 AEs, and 8 MNA economies. Pupil-teacher ratio in primary education (headcount basis), unweighted averages for 165 EMDEs, 31 AEs, and 14 MNA economies. Latest available data available during 2011-15.

BOX 2.4.1 Recent investment slowdown: Middle East and North Africa *(continued)*

electricity a binding constraint to competitiveness and doing business, and in recent years this was also the case in Egypt (World Bank 2015r; Le Borgne and Jacobs 2016). Large numbers of Syrian refugees in Jordan and Lebanon have compounded existing strains on infrastructure in those countries. In Syria, the cost of rebuilding infrastructure damaged or destroyed by war is estimated to be on the order of $100–200 billion (Gobat and Kostial 2016). Iraq, as well, faces large infrastructure investment needs, which have risen as a result of conflict.

GCC countries also have outstanding infrastructure investment needs, predominantly in electricity generation. With higher income levels, however, these countries also have greater capacity to fulfill such needs (IMF 2014a). GCC countries' planned medium-term public spending on infrastructure generally tracks their infrastructure investment needs, while planned spending in oil-importing and non-GCC oil-exporting countries lags far behind needs (Ianchovichina et al. 2013).

Besides contributing to growth, higher investment in infrastructure could also help improve labor market conditions in MNA. One study estimated that each $1 billion of infrastructure investment has the potential to generate 110,000 infrastructure-related jobs, on average, in oil-importing MNA countries (Estache et al. 2013). It is key that countries prioritize investment projects to suit country conditions, however.

MNA scores well relative to other emerging and developing regions on basic health measures. However, the region is at or below the EMDE average in terms of education indicators, despite considerable long-term gains (World Bank 2011). MNA does not necessarily need to increase the level of investment in education, which has risen substantially over several decades, but rather to invest with the goal of increasing the quality of education, thereby supporting growth and lowering poverty (World Bank 2008).

Which policies can help address investment needs?

Several policy measures could support investment in MNA. Across the region, the scaling back of subsidies since 2014 has created space for increased public spending on investment in infrastructure, health, and education (IMF 2016p). High public sector wage expenditures could be reduced, with funds reallocated to investment. Improvements in governance and investor protection could also support private sector investment, as could incentives to undertake public-private partnerships (e.g., in Morocco; EBRD 2015a). In some oil importers, the electricity sector would benefit from additional privatization (Lebanon) or efforts to incentivize the private sector's contribution to electricity generation (Egypt). Finally, improved security conditions in the region are a prerequisite for a sustained pickup in investment.