

Corruption and Foreign Direct Investment in the MENA Region: How the Arab Spring Changed Things

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This study looks at the effects of corruption on foreign direct investment (FDI) in the Middle East and North Africa (MENA) region. It utilizes 8 countries (Egypt, Tunisia, Morocco, Jordan, Oman, Saudi Arabia, Algeria, and Kuwait) over the period of 1995 – 2018. The Index of Economic Freedom provided by The Heritage Foundation is used as an independent variable with each country receiving a score from 0 to 100 (higher numbers indicating more economic freedom and less corruption). Other independent variables used are the GDP growth rate, the inflation rate, the real interest rate, the unemployment rate, and a dummy variable representing the Arab Spring that takes on a value of 0 for years prior to 2011 and a value of 1 for the years 2011-2019. The model's dependent variable is FDI (net inflows represented in current \$US) and data is obtained from the World Data Bank. Even though studies are available discussing the negative relationship between FDI and corruption, the effects of corruption on FDI in the MENA region haven't been fully evaluated due to a lack of data. This study is important because FDI is a main determinant of an economy's prosperity and living conditions. The MENA region is a relatively unstable region and with the recent Arab Spring, corruption has either increased or decreased in these countries but the change in FDI's statistical significance is yet to be determined. This paper uses OLS models to assess the effects of corruption on FDI in the MENA region before and after the Arab Spring and results show that prior to the Arab Spring, corruption had a positive effect on FDI, but this relationship changed to a negative relationship after the Arab Spring as indicated by a breakpoint between the years 1996-2010 and 2011-2018. This may be caused by initial built-in institutional inertia that allowed corruption to act as a "helping hand", but after the economic reforms that accompanied the revolutions during the Arab Spring, institutional constraints and laws were improved in a way that penalizes corruptive action by increasing the costs by more than the perceived benefit.