’ that Affects Foreign Direct Investment in the MENA Countries

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Abstract

This paper aims to analyze the dynamic relationship between foreign direct investment FDI and different kinds of risks in the MENA countries. Using the vector autoregressive technique on the country level for eleven MENA countries during the period of 1980-2003, the findings indicate that despite the fact that, the macroeconomic performance and the political (in) stability are important issues in affecting the decision of FDI and determining its location; however, the cultural environment, particularly corruption level, is also having its special effects on this theme in the MENA countries.
These results should attract the attention of policymakers; since they reveal that: it is neither the economical risk nor the political risks that mostly perform threats and shy away FDI from the MENA countries (as usually point to), but it is a contagion "disease" that is called the cultural risk.

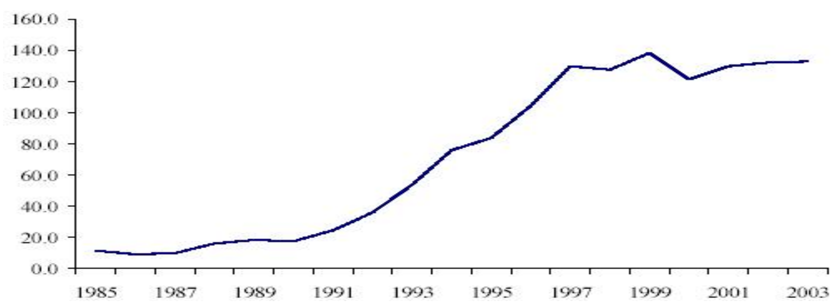
Keywords: FDI, MENA, DCs, Risks, Corruption, Vector Autoregressive Model
JEL Classification: C3, D73, E31, F21, F23, O53.

inflow reversals have been a key feature of recent emerging market crises. While short-term flows have been mostly volatile and unwanted, long-term capital flows such as foreign direct investment (FDI), which tend to be more stable, are increasingly desirable (Lipsey 2001). In addition to the volatility factor, there are many other essential motivations as to why developing economies are interested in attracting FDI; like beside being an additional financial resource, the transfer of intangible assets such as technology, know-how and technical skills, is widely accepted as being the most important motivations.

Given this importance, FDI as a source of capital in the developing world has increased considerably over the past two decades -see Figure 1- as a reflection of the improvements in the local investment perceived by investor, on account of the adoption by many countries of sound macroeconomic and structural reform measures (Chan and Gemayel, 2004).

Figure 1

Net Foreign Direct Investment to the Developing Countries, 1985-2003 (billion of US$)



Source: World Bank (2003).

Mainly, this tremendous increase in FDI is undoubtedly related to the globalization of the world economy and the integration of the financial markets, however, despite this fact; overall FDI to the MENA region was scant during this period ï see Table 1-.

Table 1

Net FDI inflows as a percentage of GDP to Developing countries, 1980-2005

	1980	1985	1990	1995	2000	2005
East Asia and Pacific	0.41	0.57	1.58	3.90	2.65	3.22
Europ and Central Asia	0.02	0.08	..	1.67	3.16	3.55
European Monetary Union	0.38	0.44	1.08	1.08	10.25	3.16
Latin America and the Caribbean	0.88	0.86	0.75	1.82	4.07	2.87
MENA	0.70	0.47	0.25	0.33	1.26	2.42
South Asia	0.09	0.10	0.14	0.63	0.72	0.98
Sub-Saharan Africa	0.06	0.44	0.41	1.44	2.02	2.70

Source: World Bank, Global Development Finance: Country Tables.

al explanation can be found, as in countries facing cases such an observation is confusing, as one would expect multinational companies to take advantage of the low production costs in the MENA region. Many observers such as Eid and Paua (2002) and Onyeiwu (2003) among others have argued that the capacity of many MENA countries to attract FDI has so far been principally determined by the existence of natural resources, as in the case of Kuwait, Qatar and Saudi Arabia. The paper is motivated by the fact that despite large increases in FDI in emerging markets since the 1980s, the MENA region share was dismal. While net FDI inflows as a percentage of GDP have grown by an average of six fold between 1985 and 2004 in most of the other regions, whilst of MENA has stagnated during that period (see Table 1).

The reminder of the paper is organized as follows: section two briefly presents a literature review on the relationship between foreign direct investment and different kinds of risks in the MENA counties; section three elucidates the methodology and describes the variables and their sources. Whereas section four illustrates the empirical results, and finally section five is a discussion of the results and conclusions.

2. LITERATURE REVIEW

Historically, countries in the MENA region have a higher level of instability associated with investment risk relative to DCs. In some cases a rational explanation can be found as, for example, for countries experiencing conflict like Algeria and Sudan; which their very difficult internal conflict is a major impediment to any investment (Garibaldi, et al., 2002). This fact is supported by Lucas (1990), when he argues that the reason why multinational companies continue to produce in high-cost developed countries is because among other factors, these countries are considered to be politically stable, whereas, investments in many ñlow-costò countries, by contrast, are exposed to political risk.

Many empirical studies such as Hawkins and Lockwood (2001), and Janeba (2002) among others have concluded that political (in) stability was found to have an impact on the inflow of FDI. Same result can be said regarding the other MENA countries (Alessandrini, 2000; Sadik and Bolbol, 2003; Onyeiwu, 2003; Mellahi, et al., 2003).

However, in many other cases such an observation is confusing, especially in countries whose their political situation is stable, and yet they suffer from a low level of FDI. In other words, while a stable political environment is desirable, it is not a sufficient condition for attracting FDI; as one would expect multinational companies to take advantage of the low production costs in the MENA region, other would expect the capacity for the MENA countries to attract FDI has so far been principally determined by the existence of natural resources (Chan Gemayel, 2003), but despite these expectations the results are still below the par.

According to UNCTAD (2002), FDI to the MENA countries recorded a longer decline of 33% dropping in 2002, from \$6.7 billion in 2001 to \$4.5 billion in 2002, which accounted for almost 2.8% of total FDI inflow in the DCs. *First* reason for that is the serious internal/ regional political instability facing major MENA countries (Algeria, Lebanon, Syria, Libya, Palestine, Iraq and Sudan) manage to affect their international

Second reason is that the MENA countries are [illegible] ility and predictability (Ngowi, 2001), which cause a reduction in the investorøs confidence, pose obstacles to sustained FDI flows, and complicate the economic development of these countries. That even hosts countries that suffer from such problems and at the same time possess abundant natural resources, how further incentives they may provide, they are still considered to be political unstable countries (Ana, 1997). *Third* reason is the fact that the macroeconomic environment in several MENA countries is still characterized by constraints such -see Table 2-, in a way that makes maintaining macroeconomic stability is a big challenge for many MENA countries (Iqbal, 2001).

One could believe that such weaknesses do explain why politically stable countries in the MENA region suffer from a high level of uncertainly that make them receive a tiny share of FDI in compare with other politically unstable countries. The *fourth* reason has been given by Allessandrini (2000) in his analysis of the FDI in the Mediterranean Region, he argues that the authorization regimes, with the exception of Israel and Lebanon, still lack automatism and transport procedures which is something not preferable for the foreign investors (although some improvements have been undertaken in Algeria, Jordan, Palestine and Morocco).

Table 2
Economic environment constraints in DCs as well as in the MENA countries

1	Fragile political systems and structure.
2	Vulnerability to violent civil or cross border conflicts.
3	Weak governance and poor administration.
4	Weak institutional capabilities with legal systems that donøt protect property rights
5	Undeveloped financial and business systems.
6	Weak regulatory regimes for enforcing fear competition.
7	Inadequate physical infrastructure and poor infrastructure services.
8	Relatively undeveloped markets.
9	Low level of human and social capital.
10	Exchange controls and weak currencies subject to large frequent devaluations.

(Development financing, 2000).

Certainly, the environment climate, macroeconomic performance and the political (in) stability are important issues in determining the location of FDI. However, the cultural environment (communications, religions, values and ideologies, and social structure) has also special importance in multinational business. The importance of understanding the cultures of countries in which a multinational company operates ï as well as similarities and differences among those cultures ï becomes clear when we look at the multitude of modern managerøs blunders in multinational business (Miroshnik, 2002).

Management practices that are suited for their own culture environment may bring about undesirable, perhaps terrible, consequences in another culture. For example, problems result when managersø export marketing campaigns developed in one country without adapting them to another country. For instance; Muslim people will never eat any a picture of any naked human. In addition, cultural he organization must reach a single agreement. For instance, negotiations between Japanese and Arabic people are very difficult, because of the big differences in the decision-making and the legal system. Japanese never say “no”, it is very impolite in their opinion, but it does not mean that they agree, so they will say, “yes, we are absolutely disagreeing”. However, for the Arabs, if the partner says “yes”, it is the time to celebrate the success.

To avoid such problems: either the multinationals choose a location where the physical distance is shorter and cultural barriers are easily overcome (Galan and Benito, 2001), for example, the gravity model used by Gao (2005) shows that the huge amount of FDI inflow from Taiwan, Singapore and Hong Kong to China is mainly due to the cultural ties and geography closeness between them. Or it can allocate in a far distance place; where the foreign investor choose to have a partnership from appropriate local business to help him deal with the national culture difference (Pan and Chi, 1999). Otherwise, to work alone; where in this case the modern managers must understand the core concept of the culture. To ignore cultural differences is unproductive, however; judging cultural differences as good or bad can lead to inappropriate, racist, sexist, and ethnocentric behaviors (Hanson, 1999), while, recognizing cultural differences does not (Adler, 1983a; 1983b).

This paper extends the limited empirical literature on the risks that affects FDI inflows to the MENA countries, by answering the following question on the country level, which is the main dominant risk (economical, political, and cultural risk) that affects FDI inflows? And what is the dynamic relationship between FDI inflows and these risks?

3. METHODOLOGY

The use of vector autoregressive VAR model is to investigate the simultaneous interactions of dominant risks and FDI flows. The VAR technique as applied to a simultaneous equation system, estimates unrestricted reduced form equations with uniform sets of the lagged dependent variables of each equation as regressors. Because this approach sets no restrictions on the structural relationships of the economic variables, it avoids mis- specification problems. The VAR methodology is suitable when variables within the model are highly autocorrelated. Furthermore, the VAR approach enables us to analyze the speed of information transmission among variables in the system, which would provide insight into the dynamic nature of the interactions between FDI flows and three kinds of risks for each country.

The VAR model can be expressed in its standard form as:

$$FDI(t) = c + \sum_{k=1}^{p} A(k) FDI(t-1) + e(t) \qquad (1)$$

Where FDI*(t)* is a 4x1 column vector of FDI flows and three kinds of risks (inflation rate, logarithm political risk index and logarithm corruption index) in time *t*. *C* is a 4x1 column vector of constant terms, *A(k)* is a 4x4 matrix of Coefficients such that the (*i*, *j*)th component of *A(k)* measures the direct effect that a change in the *i*th variable has upon the *j*th variable after *k* periods.

In particular, the *i*th component of e(*t*) is the innovation of the *i*th variable that cannot be predicted from the past values of other values in the system. e(*t*) is a 4x1 that $E(e_{it}) = 0$, $E(e_{it}^2) = \sigma_i^2$, $E(e_{it}, e_{jt}) = \sigma_{ij}$ and

Thus, the innovations, e(t), are serially uncorrelated but can be contemporaneously correlated. To analyze the dynamics of the system, I trace out the system's moving average representation which may provide additional insight into the dynamic interactions among the variables in the VAR model (Sims 1980). Thus, the VAR model of equation (1) is typically transformed into its moving average representation expressed as:

$$FDI(t) = \sum_{k=0}^{\infty} B(k)e(t-k) \tag{2}$$

Equation (2) indicates that FDI(t) is a linear combination of current and past one-step-ahead forecast errors (i.e. e(t)). The (i, j)th component of $B(k)$ reveals the response of the ith variable to a unit random shock in the jth variable after k periods. The moving average model of equation (2) enables us to compute the m-step-ahead forecast error of FDI(t) at time t-m+1 which can be expressed as $\sum B(k)e(t-k)$ for K=0 to m-1. In addition, the variance decomposition of the forecast error gives us the percentage of unexpected variation in each variable that is produced by shocks from other variables in the system.

As stated earlier, the innovations, e(t) in equation (1) may be contemporaneously correlated, for example, the covariance matrix of innovations is not diagonal. When innovations in variables are contemporaneously correlated, a shock in one variable may work through the contemporaneous correlations with innovations in other variables. It is customary to transform these correlations by orthogonalizing the innovations in the VAR system according to a pre-specified causal ordering. After the transformation, the above equation can be expressed as,

$$FDI(t) = \sum_{k=0}^{\infty} c(k)u(t-k) \tag{3}$$

Where the transformed innovations u(t), are now uncorrelated with each other at all lags as well as contemporaneously. The moving-average representation of the VAR model provides a convenient framework for tracing the dynamics to shocks in the system. The (i, j)th component of $C(k)$ in equation (3) represents the impulse response of the ith variable in k periods after a shock of one standard error in the jth variable. That is, if there is a unit shock in the innovation of the jth variable in period $t(u_{jt})$, the value of the ith variable (FDI_i), changes by $c_{ij,1}$ in the following period and by $c_{ij,2}$, $c_{ij,3}$ and so on in successive future periods. The VAR model also makes it possible to analyze the decomposition of forecast error variance thereby providing a measure of the overall relative importance of an individual variable in generating variations in its own and on other variables. That is, the effect that each variable in the system has on itself and on each other variables over different time horizons can be measured by decomposing this forecast variance error.

In summary, the VAR analysis provides information on two important aspects of the structure of interactions among the FD flows and the three kinds of risks that affected FDI: (1) if innovations in a particular risk explain a substantial amount of variations in other variables and cannot be accounted for by innovations in other risks, then the risk is relatively influential to other risks and FDI, and (2) if the impulse response of FDI to a uickly, then FDI response effectively and quickly to

The VAR requires the determination of the appropriate lag structure in the system. I chose the lag structure using the Akaike Information Criterion (AIC) in conjunction with analyzing the estimated modelôs residuals, so they do not exhibit any significant autocorrelation.

3.1. Data Sources

The ñrawò data set for this study includes the whole population of Middle East and North Africa Countries; which accounts for 19 countries. However, the actual estimation of the model has removed two countries of Iraq and Palestine, since the war on the first one and the occupation on the second one cause unavailability of data. With this restriction and missing country observations, the sample abates to 17 countries for the period 1980-2003.

Data sources are obtained from two sources: The main part is from the World Development Indicators published by the World Bank and the second source is from the International Country Risk Guide / ICRG. Unfortunately, the time series of FDI inflows as a percentage of GDP for 6 countries (Kuwait, Lebanon, Libya, Qatar, UAE, and Yemen) are short, and therefore we could not run the VAR on them, that reduce my sample to 11 countries only.

3.2. Description of the Variables

Net FDI Inflows as Percentage of GDP (FDI/GDP)

Net FDI inflows (FDI/GDP), is the sum of (net) equity of capital, reinvestment of earnings, other long-term capital, and short term-capital as shown in the balance of payment. The net FDI inflows is used rather than FDI stock, because data on capital stock are not comprehensive, and are expressed in book values without any adjustment for inflation and exchange rate variations. Beside that the use of net FDI inflows as percentage of GDP is to avoid the possibility of having a nonstationary endogenous variable in the regression, and to control for the size of the country which naturally affects the level FDI observed by each country - it quite misleading to compare countries in term of FDI flows without referring to their respective economic size -. The World Development Indicators are the sources of this variable.

Inflation Rate

Inflation rate is a key indicator of fiscal and monetary policies of a country; the stability of the price level is particularly important for the process of economic decision taking, which requires that prices perform their usual information function and that their changes remain predictable (Kamar and Bakarzhieve, 2002). If we take the MENA economies as an example, most of them experienced a general deceleration in inflation as a result of prudent monetary and fiscal policies. Generally, tightened demand management policies and in some countries exchange rate corrections, helped to reduce external current account deficits. But despite this deceleration in inflation, it seems that the group of MENA countries adopting floating exchange rates registered higher inflation rates than the pegged group (like Jordan and other Gulf Cooperation Countries). As in year 2000, Sudan and Yemen (adopting a floating exchange rate regime) registered the

10% and 9%, respectively) compared to an average of ...eration Countries (Karam, 2001). This explains one of the reasons why FDI inflow – for example- in the Gulf Cooperation Countries is higher than in Yemen. According to Froot and Stei (1991) and Makki and Somwatu (2004), a lower inflation rate should mean a better climate for investment, trade and therefore, economic growth, which has been supported by Apergis and Katrakilidis, (1998) when they argue that inflation and inflation uncertainty are found to affect FDI negatively. These facts could explain the use of inflation rate as a suitable proxy for macroeconomic stability. Also the World Development Indicators are the sources of this variable.

Corruption Index (green instead of this, if yes delete their references)

Cultural differences are reflected in the formal governance structures, laws, and practices, as well as in the more informal, undocumented contracting practices of the market, all of which impact firm transactions (Kostova and Zaheer, 1999). The foreign firm must not only obtain a thorough understanding of the formal government structures that dictate the firm's external market relationships, the firm must also understand the informal practices that facilitate, impede, or correspond with the formal processes. One significant example of informal practices involves the level of corruption in the external environment; as a part from raising the cost of doing business, corruption slows down the process of obtaining the business permits necessary for operating in the host country (Onyeiwu, 2000). Beside that, when a country has a higher level of corruption (which is the case in most of the DCs as well as in the MENA countries) there are more covert practices about which the foreign firm is not likely to be fully knowledgeable than for a foreign firm in another country with a low level of corruption.
Erlich and Lui (1999) argue that corruption appears to be higher in poorer countries than in countries with stronger economies, but occurs in virtually all economies. The DCs is a good example here; although the overall investment climate in the DCs have changed for better, but still corruption, bureaucratic red tape and duplication, exist and manage successfully to deter country. Indeed, an understanding of how FDI and uncertainty relate to corruption can aid policy developers in both governmental and private enterprise settings. For example, if a manger at a multinational firm that is considering a potential market is aware that market has pattern of high corruption followed by massive influx of FDI, certain procedures and protocols for dealing with local contacts may need to be adjusted depending on current economic situation (Robertson and Watson, 2004).

This is an assessment of corruption within the cultural system. Such corruption is a threat to foreign investment for several reasons: it distorts the both the cultural as well as the economic environment; it reduces the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability; and introduces an inherent instability into the economical process. Beside that, when a country has a higher level of corruption (which is the case in most of the DCs as well as in the MENA countries) there are more covert practices about which the foreign firm is e than for a foreign firm in another country with a low his index in this study is expected to be ambiguous, noting that the ICRG has scored this index as: of 6 points equates to very low corruption and a score of 0 points to very high corruption.

Political risk index

The aim of the political risk rating is to provide a means of assessing the political stability of the countries covered by ICRG on a comparable basis. This is done by assigning risk points to a pre-set group of factors, termed political risk components, such as government Stability, socioeconomic conditions, military in politics, law and order, etc. According to ICRG a political risk rating of 0.0% to 49.9% indicates a very high risk; 50.0% to 59.9% high risk; 60.0% to 69.9% moderate risk; 70.0% to 79.9% low risk; and 80.0% or more very low risk. The sign of this index is expected to be negative.

4. EMPIRICAL RESULTS

4.1. Variance Decomposition

The variance decomposition analysis measures the percentage of forecast error of a variable that is explained by another variable. It indicates the relative impact that one variable has upon another variable within the VAR system. The variance decomposition enables us to assess the economic significance of these impacts as the percentage of the forecast error for a variable sum to one. The orthogonalization procedure of the VAR system decomposes the forecast error variance; the component that measures the fraction of fluctuations in variables of particular variable explained innovations in each of the four variables (FDI, and inflation, corruption, political risks).

Table 3 provides the variance decomposition of the 2-, 4-, and 6- year ahead forecast errors of each variable, accounted by innovations in each four variables.

The results indicate that all the risks are pretty exogenous ï but not very strongly- in the sense that the percentage of innovations with respect to FDI does not exceed 84% - in the case of Oman- (noting that this result is supported by the previous finding; that a considerable interaction exists among the oil and non-oil countries). The percentage of risk explanatory power as indicated by the ñallò column is very strong, reaching 99% at times.

Though the degree of influenced differs across countries, Table 3 shows that (for example) FDI in Algeria influences all the three risks and accounts for between 0.32% and 13.62% of the forecast error variance of these risks. Whereas, FDI in Saudi Arabia influences all risks and accounts for between 4.04% and 44.66% of the forecast error variance of these risks. But since the main aim here is measuring the percentage of forecast error of FDI that is explained by risks, the concentration will be on the first three ll the risks collectively explain only 3.21% of the rocco, whereas, these risks explain 42.96% of the fluctuations in FDI flows in Sudan.

The results also indicate that there is a dominant risk that influences FDI flows in each country and links their interdependence. Political risk influences FDI flows in four out of eleven countries (Algeria, Iran, Jordan, and Tunisia). For Algeria; this risk performs 87% of all risks (15.43÷17.68) that causes fluctuation in FDI flows, and performs 72% of all the risks that cause fluctuation in FDI flows in both Jordan (20.69÷28.76) and Iran (7.3÷10.2). Five of the eleven countries (Bahrain, Oman Morocco, Sudan, and Syria) their FDI flows influenced by corruption risk; since it performs 95% and 85% of all the risks that cause fluctuation in FDI flows in Syria (17.33÷18.29) and Oman (71.6÷84.04) respectively. Finally, the inflation risk influences FDI flows in two out of the eleven countries (Egypt, and Saudi Arabia), where it performs 90% off all risks that influence FDI in Saudi Arabia (45.04÷50.13) and 69% in Egypt (10.03÷14.55).

of forecast error of FDI flows for each country

Country		Horizon (years)	By Innovation in: FDI Inflows	Inflation Rate	Corruption	Political Risk	All
Algeria	FDI Inflows	2	96.46	1.30	0.00	2.24	3.54
		4	89.43	2.22	0.02	8.32	10.57
		6	82.32	2.21	0.03	15.43	17.68
	Inflation Rate	2	0.32	98.54	0.32	0.82	1.46
		4	0.64	92.15	1.75	5.46	7.85
		6	2.53	80.70	3.17	13.61	19.30
	Corruption	2	7.09	2.18	90.62	0.11	9.38
		4	11.15	1.23	86.54	1.08	13.46
		6	13.62	1.06	82.28	3.04	17.72
	Political Risk	2	1.81	0.09	84.37	13.73	86.27
		4	2.61	0.21	83.45	13.73	86.27
		6	2.87	0.40	82.85	13.88	86.12
Bahrain	FDI Inflows	2	74.15	5.24	14.29	6.32	25.85
		4	63.80	5.66	22.99	7.55	36.20
		6	50.71	4.11	37.57	7.60	49.29
	Inflation Rate	2	18.52	50.66	24.56	6.25	49.34
		4	19.66	37.27	38.91	4.16	62.73
		6	25.25	27.45	35.83	11.47	72.55
	Corruption	2	15.24	4.62	79.64	0.50	20.36
		4	29.81	5.84	54.96	9.39	45.04
		6	44.20	4.07	26.65	25.08	73.35
	Political Risk	2	15.46	29.83	8.21	46.50	53.50
		4	18.10	34.79	7.27	39.84	60.16
		6	23.10	28.64	14.42	33.84	66.16
Egypt	FDI Inflows	2	98.49	0.05	0.14	1.32	1.51
		4	88.18	7.92	2.49	1.41	11.82
		6	85.45	10.03	3.11	1.42	14.55
	Inflation Rate	2	30.62	58.40	6.87	4.11	41.60
		4	22.74	63.80	6.25	7.21	36.20
		6	21.29	57.53	15.41	5.77	42.47
	Corruption	2	0.38	0.77	98.15	0.70	1.85
		4	15.32	4.80	76.43	3.45	23.57
		6	12.95	10.85	64.03	12.17	35.97
	Political Risk	2	2.29	8.39	40.38	48.94	51.06
		4	2.45	8.93	41.34	47.28	52.72
		6	3.26	8.61	42.50	45.64	54.36

Entries in each cell are the perecntage of forecast error variance of the variable in the first column explained by the variable in the first row.
Entries in the "All" column denote the total percentage of forecast error variance of the variable in the first column explained by all other variables.

of forecast error of FDI flows for each country

Country		Horizon (years)	By Innovation in: FDI (%GDP)	Inflation Rate	Corruption	Political Risk	All
Iran	FDI Inflows	2	93.19	0.13	1.14	5.55	6.81
		4	92.47	1.05	1.34	5.14	7.53
		6	89.80	1.52	1.38	7.30	10.20
	Inflation Rate	2	17.97	73.91	2.26	5.86	26.09
		4	11.77	32.25	6.99	48.99	67.75
		6	6.18	25.74	12.15	55.93	74.26
	Corruption	2	3.55	3.89	91.74	0.82	8.26
		4	28.92	4.28	64.51	2.28	35.49
		6	43.11	3.33	44.10	9.46	55.90
	Political Risk	2	3.17	2.70	67.28	26.85	73.15
		4	33.13	2.02	46.47	18.38	81.62
		6	52.12	2.01	33.07	12.80	87.20
Jordan	FDI Inflows	2	90.81	3.18	3.19	2.81	9.19
		4	81.04	1.85	2.99	14.11	18.96
		6	71.24	2.20	5.87	20.69	28.76
	Inflation Rate	2	1.37	88.65	8.12	1.86	11.35
		4	7.41	66.41	22.97	3.21	33.59
		6	7.09	64.92	22.01	5.99	35.08
	Corruption	2	7.13	5.89	86.98	0.00	13.02
		4	8.21	8.37	83.37	0.04	16.63
		6	9.15	7.54	83.23	0.08	16.77
	Political Risk	2	6.61	5.47	86.22	1.69	98.31
		4	5.49	8.40	85.09	1.02	98.98
		6	5.13	8.13	85.72	1.02	98.98
Morocco	FDI Inflows	2	99.15	0.71	0.12	0.02	0.85
		4	96.79	0.76	2.42	0.03	3.21
		6	97.51	0.98	1.49	0.01	2.49
	Inflation Rate	2	19.83	77.16	3.01	0.00	22.84
		4	21.30	48.72	29.76	0.22	51.28
		6	23.56	33.77	42.51	0.16	66.23
	Corruption	2	0.98	3.51	95.44	0.07	4.56
		4	1.17	5.64	93.12	0.07	6.88
		6	1.83	5.12	92.92	0.12	7.08
	Political Risk	2	0.62	2.31	96.87	0.20	99.80
		4	1.19	5.04	93.61	0.15	99.85
		6	5.02	5.29	89.55	0.14	99.86

Entries in each cell are the perecntage of forecast error variance of the variable in the first column explained by the variable in the first row.
Entries in the "All" column denote the total percentage of forecast error variance of the variable in the first column explained by all other variables.

of forecast error of FDI flows for each country

			By Innovation in				
Country	FDI (%GDP)	Horizon (years)	FDI (%GDP)	Inflation Rate	Corruption	Political Risk	All
Oman	FDI Inflows	2	94.94	4.92	0.01	0.13	5.06
		4	53.22	6.48	31.43	8.88	46.78
		6	15.96	6.28	71.65	6.11	84.04
	Inflation Rate	2	6.12	75.51	0.04	18.33	24.49
		4	7.27	60.83	13.12	18.78	39.17
		6	3.71	25.00	63.04	8.24	75.00
	Corruption	2	0.30	0.72	98.95	0.04	1.05
		4	2.57	0.57	96.75	0.11	3.25
		6	0.23	1.41	98.14	0.22	1.86
	Political Risk	2	6.38	49.23	3.58	40.81	59.19
		4	6.65	50.30	2.81	40.24	59.76
		6	6.14	49.94	4.89	39.03	60.97
Saudi Arabia	FDI Inflows	2	67.60	28.08	4.11	0.21	32.40
		4	64.86	28.27	6.37	0.50	35.14
		6	49.87	45.04	4.71	0.37	50.13
	Inflation Rate	2	35.43	63.28	1.24	0.05	36.72
		4	44.66	52.21	3.05	0.08	47.79
		6	44.63	51.92	3.35	0.10	48.08
	Corruption	2	4.09	20.23	75.35	0.33	24.65
		4	20.44	17.65	61.58	0.33	38.42
		6	27.38	31.15	41.13	0.34	58.87
	Political Risk	2	4.27	21.42	73.09	1.22	98.78
		4	21.19	19.08	58.68	1.05	98.95
		6	31.77	27.48	39.98	0.77	99.23
Sudan	FDI Inflows	2	71.43	0.86	27.66	0.05	28.57
		4	57.04	6.27	35.99	0.70	42.96
		6	50.79	11.10	37.54	0.58	49.21
	Inflation Rate	2	0.56	87.07	5.96	6.41	12.93
		4	8.62	61.18	14.86	15.33	38.82
		6	15.38	51.94	21.10	11.58	48.06
	Corruption	2	21.26	6.72	69.96	2.06	30.04
		4	26.69	15.22	56.40	1.69	43.60
		6	27.73	18.47	52.39	1.41	47.61
	Political Risk	2	6.12	8.18	3.14	82.56	17.44
		4	15.92	21.40	12.63	50.05	49.95
		6	19.21	24.35	17.92	38.53	61.47

Entries in each cell are the perecntage of forecast error variance of the variable in the first column explained by the variable in the first row.

Entries in the "All" column denote the total percentage of forecast error variance of the variable in the first column explained by all other variables.

of forecast error of FDI flows for each country

Country	FDI (%GDP)	Horizon (years)	By Innovation in FDI (%GDP)	Inflation Rate	Corruption	Political Risk	All
Syria	FDI Inflows	2	89.91	0.92	9.16	0.00	10.09
		4	83.22	0.85	15.91	0.02	16.78
		6	81.71	0.92	17.33	0.04	18.29
	Inflation Rate	2	7.61	91.81	0.34	0.25	8.19
		4	7.17	89.09	2.95	0.79	10.91
		6	6.55	87.13	5.27	1.04	12.87
	Corruption	2	20.64	1.59	77.77	0.01	22.23
		4	25.42	3.22	71.33	0.02	28.67
		6	25.71	4.19	70.09	0.02	29.91
	Political Risk	2	0.72	47.81	26.82	24.66	75.34
		4	1.43	60.87	21.77	15.94	84.06
		6	1.24	63.48	22.05	13.22	86.78
Tunisia	FDI Inflows	2	94.25	2.84	2.20	0.71	5.75
		4	84.78	2.64	6.68	5.89	15.22
		6	78.60	2.74	9.26	9.40	21.40
	Inflation Rate	2	30.61	61.96	0.04	7.39	38.04
		4	30.72	46.90	0.37	22.01	53.10
		6	28.47	40.67	0.37	30.49	59.33
	Corruption	2	5.30	7.99	85.99	0.71	14.01
		4	9.04	14.57	75.82	0.57	24.18
		6	12.57	17.66	69.12	0.65	30.88
	Political Risk	2	9.44	0.96	1.23	88.37	11.63
		4	9.55	1.52	0.98	87.95	12.05
		6	10.31	2.40	1.81	85.47	14.53

Entries in each cell are the perecntage of forecast error variance of the variable in the first column explained by the variable in the first row.

Entries in the "All" column denote the total percentage of forecast error variance of the variable in the first column explained by all other variables.

4.2. Impulse responses of FDI to chocks in risks

The estimated impulse responses of the VAR system offer an additional way of examining how FDI inflows respond to innovations from risks. Tables 4 and Figure 2 summarize the impulse responses of FDI to Cholesky one standard deviation unit shock in inflation, corruption, and political risks for each country.

Accumulated Response of FDI to One S.D Innovations in Inflation, Corruption, and Political Risks for each country

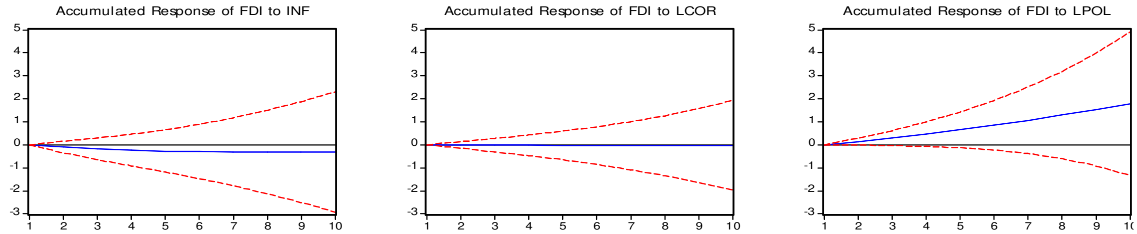
	Algeria			Bahrain			Egypt			Iran		
Period	INF	COR	POL	INF	COR	POL	INF	COR	POL	INF	COR	POL
1	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
2	-0.102	-0.004	0.133	2.133	3.522	-2.342	0.030	-0.053	0.162	-0.011	-0.032	0.070
3	-0.179	-0.013	0.290	2.935	-0.532	-1.487	0.369	-0.055	0.246	-0.034	-0.046	0.085
4	-0.233	-0.023	0.462	4.335	-0.089	0.333	0.637	-0.292	0.236	-0.055	-0.060	0.099
5	-0.270	-0.032	0.649	3.959	4.362	0.594	0.827	-0.345	0.258	-0.073	-0.073	0.154
6	-0.294	-0.038	0.850	3.885	8.586	-1.381	0.981	-0.467	0.226	-0.091	-0.072	0.160
7	-0.308	-0.041	1.065	4.076	6.949	-3.203	1.054	-0.629	0.137	-0.098	-0.052	0.122
8	-0.314	-0.041	1.292	4.463	5.151	-5.104	1.090	-0.795	0.041	-0.087	-0.027	0.105
9	-0.316	-0.035	1.532	3.288	6.116	-7.676	1.113	-0.986	-0.085	-0.071	-0.012	0.095
10	-0.313	-0.025	1.785	0.877	9.751	-11.169	1.119	-1.195	-0.224	-0.062	-0.007	0.083

	Jordan			Morocco			Oman			Saudi Arabia		
Period	INF	COR	POL	INF	COR	POL	INF	COR	POL	INF	COR	POL
1	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
2	0.169	-0.425	0.883	-0.105	-0.043	-0.019	0.074	-0.003	0.012	-0.310	-0.168	0.005
3	0.032	-0.501	0.356	-0.070	-0.237	-0.031	0.067	-0.154	-0.129	-0.478	-0.319	0.010
4	-0.132	-0.487	0.249	-0.107	-0.175	-0.030	-0.029	-0.374	-0.133	-0.446	-0.384	0.020
5	-0.197	-0.459	0.103	-0.017	-0.188	-0.030	-0.225	-0.447	-0.314	-0.336	-0.414	0.028
6	-0.273	-0.300	-0.264	-0.182	-0.012	-0.040	-0.293	0.318	-0.375	-0.244	-0.442	0.030
7	-0.302	-0.153	-0.387	-0.085	-0.095	-0.049	-0.213	2.308	-0.411	-0.203	-0.472	0.024
8	-0.318	0.000	-0.531	-0.138	0.198	-0.042	0.052	4.071	-0.323	-0.204	-0.499	0.014
9	-0.339	0.155	-0.619	0.107	0.292	-0.030	0.065	0.337	-0.288	-0.224	-0.520	0.002
10	-0.346	0.273	-0.604	-0.131	0.737	-0.036	-1.168	-15.830	-0.693	-0.244	-0.534	-0.010

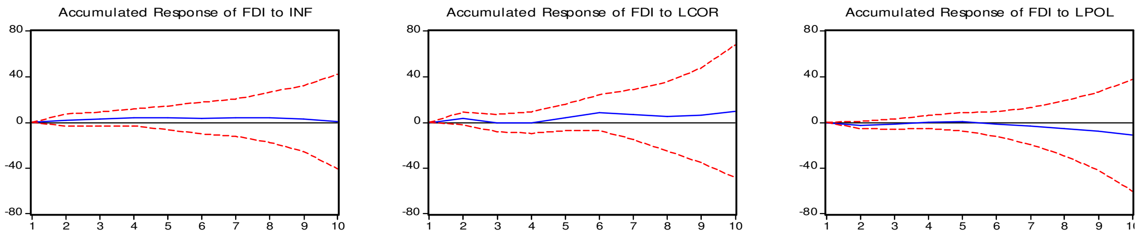
	Sudan			Syria			Tunisia		
Period	INF	COR	POL	INF	COR	POL	INF	COR	POL
1	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
2	-0.119	-0.675	-0.029	0.054	0.171	0.003	-0.191	0.168	0.095
3	0.097	-1.175	0.079	0.067	0.314	-0.001	-0.237	0.356	0.283
4	0.418	-1.658	0.154	0.058	0.414	-0.008	-0.225	0.541	0.488
5	0.763	-2.100	0.170	0.043	0.486	-0.014	-0.183	0.708	0.678
6	1.077	-2.494	0.133	0.030	0.538	-0.019	-0.130	0.852	0.840
7	1.338	-2.829	0.061	0.019	0.576	-0.023	-0.074	0.973	0.969
8	1.541	-3.103	-0.026	0.011	0.605	-0.025	-0.021	1.073	1.068
9	1.692	-3.321	-0.115	0.004	0.626	-0.027	0.027	1.155	1.140
10	1.799	-3.488	-0.196	-0.002	0.643	-0.028	0.070	1.224	1.190

Cholesky Ordering: FDI Inflows, Inflation, Corruption, Poiltical Risk
Standard Errors: Monte Carlo (100 repetitions)

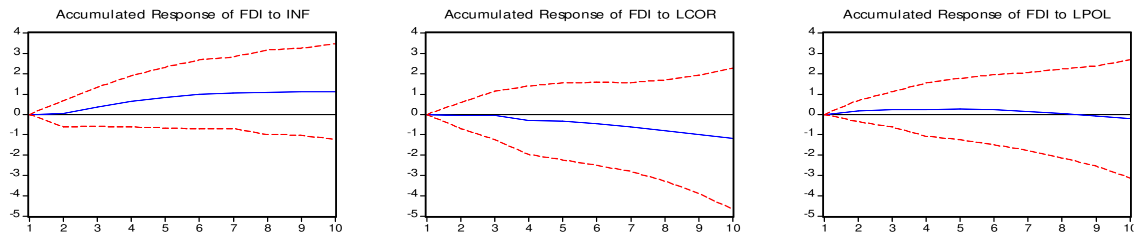
Response to FDI One S.D. Innovations ± 2 S.E.
for Algeria



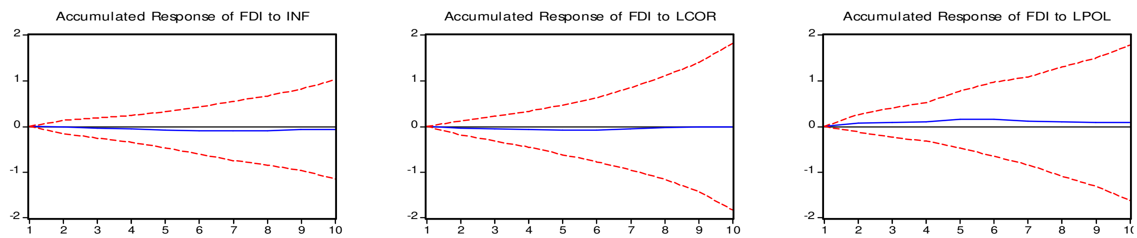
Accumulated Response of FDI to Cholesky One S.D. Innovations ± 2 S.E.
to Bahrain



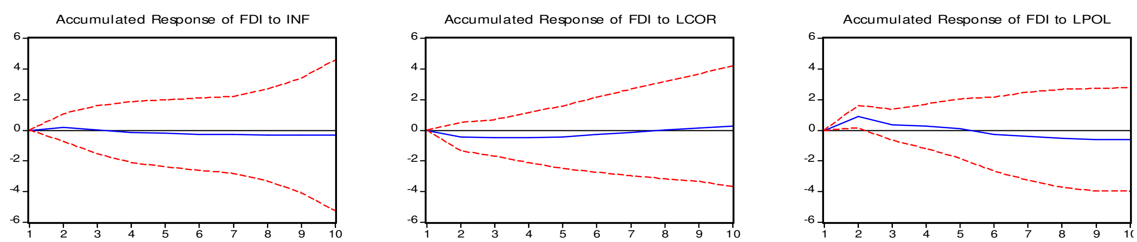
Accumulated Response to FDI One S.D. Innovations ± 2 S.E.
for Egypt



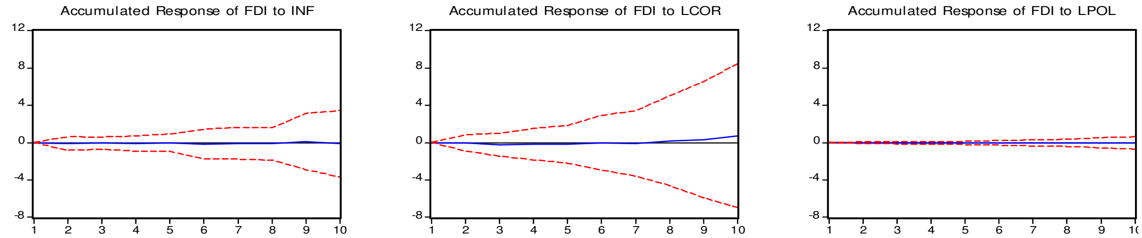
Accumulated Response to FDI One S.D. Innovations ± 2 S.E.
for Iran



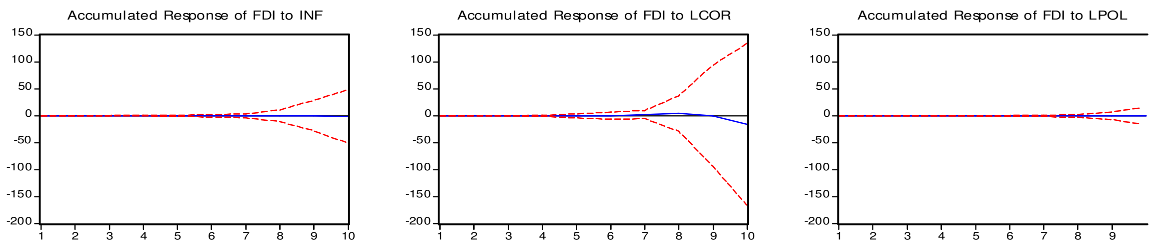
Accumulated Response to FDI One S.D. Innovations ± 2 S.E.
for Jordan



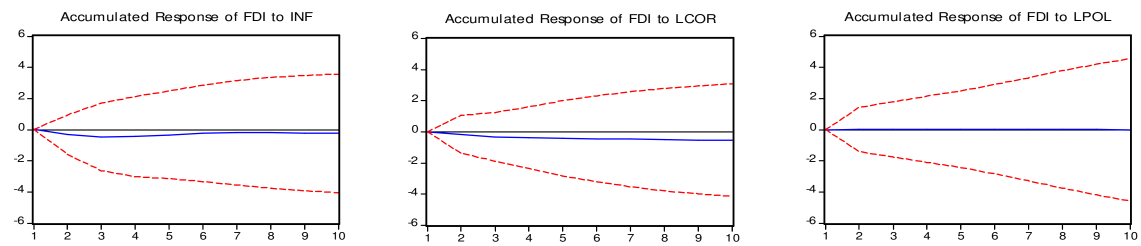
Response to FDI One S.D. Innovations ± 2 S.E.
for Morocco



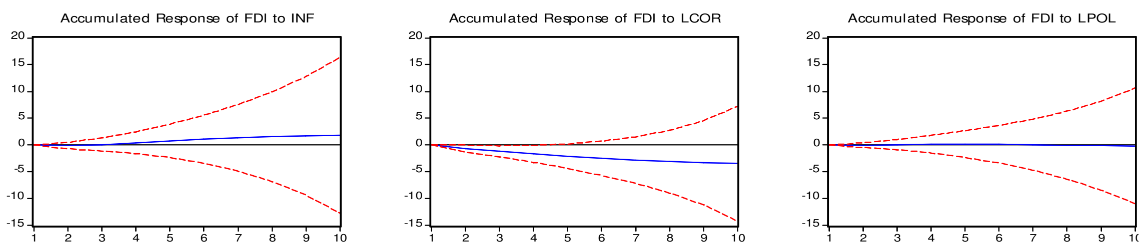
Accumulated Response for FDI to Cholesky One S.D. Innovations ± 2 S.E.
to Oman



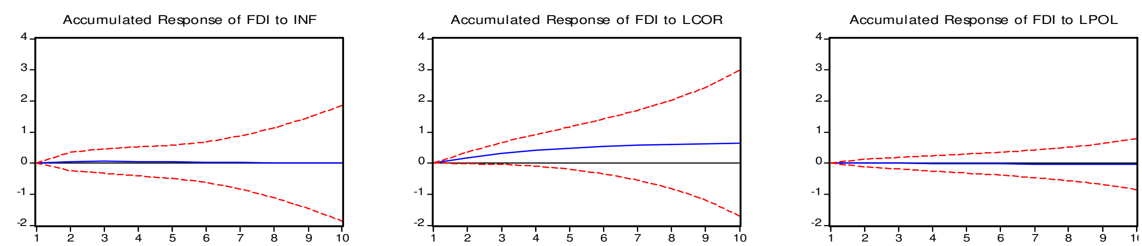
Accumulated Response to FDI One S.D. Innovations ± 2 S.E.
for Saudi Arabia

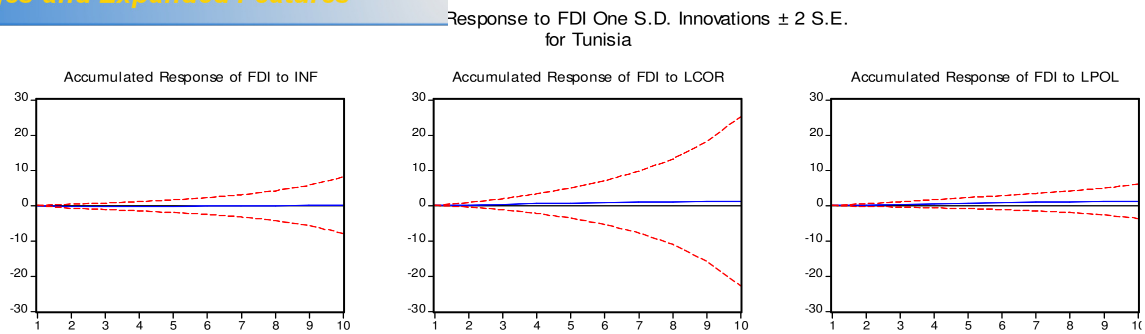


Accumulated Response to FDI One S.D. Innovations ± 2 S.E.
for Sudan



Accumulated Response to FDI One S.D. Innovations ± 2 S.E.
for Syria





Starting with Algeria, its FDI inflows react positively to a chock originated in political risk, and this reaction is increasing with time (1.785 for period 10 years). However, FDI react negatively to a chock generated in inflation, and this reaction taper off very slowly with time horizon. As for Bahrain, there is unclearness about the dominant risk that affects FDI inflows, but it seems that corruption risk can be characterized to be a dominant risk; knowing that FDI reacts positively to a chock in corruption and inflation but it reacts negatively to a chock in political risk. While it is obvious for Egypt that economical risk plays a dominant role; since inflation has the most effect on FDI, whereas, FDI reacts negatively to a chock in corruption.

For Iran, it is not clear which is the dominant risk, however there are some indicators that political risk relatively plays significant role in affecting FDI. The same results can be implemented for Jordan; that FDI has persistent reaction to chocks generated from political risk. In addition, FDI in Jordan reacts effectively to chocks from corruption. While in Morocco, cultural risk finds to play a dominant role in affecting FDI; since corruption (the proxy for cultural risk) has the major influence in affecting FDI.

Oman shows different picture in the duration how FDI reacts to chocks in different kinds of risks. FDI starts reacting to chocks generated in inflation from the fifth year, while it takes FDI three years to start reacting to chocks originated in both corruption and political risks. Given that the chock in the corruption has the most effect on FDI is an indication that in of Oman, cultural risk can be considered the dominant risk that affects FDI flows. This is not the case for Saudi Arabia; results in Table 4 show that the most react of FDI goes towards chocks originated in both inflation and corruption. While the way of FDI reaction to corruption risk increasing with time horizons, whilst for inflation, it seems that this reaction taper off slowly with time horizon. Concerning political risk, it is obvious that it plays a marginal role in affecting FDI there.

In the case of Sudan, corruption risk stands the first among other risks that affect FDI flows, one can find that the impulse responses remaining as high as -3.488 followed by inflation 1.799 at the end of tenth year. The impulse responses of FDI in Syria indicate that the chocks of corruption risk has the most effect on FDI among other risks; since FDI in general shows a slow and persistence process in responding to corruption's chocks, indicating that cultural risk is the dominant risk in Syria.

Finally, the impulse responses to FDI in Tunisia indicate that corruption and political risks affecting FDI in general more than inflation; since the reaction of FDI in this

...l political characterized to be persistence, and remain ...ly at the end of tenth year.

In sum, despite the different magnitude of the variance decomposition and the impulse responses values of FDI inflows in the MENA countries, some observations can be made from Tables 3 and 4:

1- Cultural risk plays a dominant role among the other risks that affect FDI in the MENA countries on the country level. According to the impulse responses, 6 out of 11 countries (Bahrain, Oman, Saudi Arabia, Morocco, Sudan, and Syria) cultural risk found to be dominant risk. Where this result has been supported by the variance decomposition, except that cultural risk influences FDI fluctuations in 5 out from 11 countries (Bahrain, Oman, Morocco, Sudan, and Syria).
2- Subsidizing the countries into two regions (oil and non-oil countries), the variance decomposition indicates that for the oil countries both political and corruption risks manage to be at the same level as dominant risks affecting FDI. Political affects FDI inflows in 2 out from 5 oil-countries (Algeria and Iran), and corruption affects FDI inflows also in 2 out from 5 oil countries (Bahrain and Oman), whereas, corruption risk is a dominant risk that affects FDI flows in 3 out from 6 non-oil countries (Morocco, Sudan, and Syria). The impulse responses analysis manage to give a clearer picture; where cultural risk appears to be the dominant risk that causes fluctuations in FDI inflows in the two regions. 3 out of 5 oil countries (Bahrain, Oman, and Saudi Arabia) and also in 3 out of 6 non-oil countries (Morocco, Sudan, and Syria), so it can be said that cultural risk is the dominant risk for oil and non-oil countries.
3- In general, FDI inflows show a slow and persistence process in reacting to the chocks originated from different risk, especially for political risk. Since both of the impulse responses and variance decomposition agreed that political risk is the second dominant risk that affects 4 out from 11 countries (Algeria, Iran, Jordan, and Tunisia).
4- Economical risk found to be the least risk that affects FDI on the country base. One out from eleven countries (Egypt) the economical risk (proxied by inflation risk) has a dominant effect on FDI according to impulse responses, whereas, it has that kind of effect on FDI flows on only two countries (Saudi Arabia and Egypt) according to the variance decomposition analysis.

5. DISCUSION AND RESULTS

In this paper I tried to explore the most dominant risk that affects FDI inflows, and therefore discourage foreign investors from investing in the MENA countries.

Having taking the country characteristics into account, the chosen risks have been analyzed on FDI inflows for each country individually through using the vector autoregressive technique. Results from both the variance decomposition and impulse responses analysis indicate that the cultural risk was the dominant risk that affects FDI inflows in the case of each country individually, and then it is followed immediately with the political risk as the second dominant risk.

The economical risk has proved to take the last and the miner role in affecting FDI in the MENA countries individually. Despite the existence of such risks, foreign investors may not give them a great deal of interest. It seems that the availability of

...iddle East countries, the reasonability of human costs, ... and strategic location , and the international political and economical agreements, have managed to eliminate the power of economical problems in the calculations of foreign investors. This could be seen from the kinds of FDI exists in the MENA countries and from their privileges; nearly all the foreign direct investments in the MENA countries are exports oriented not a market oriented or an efficiency one, and in some cases this investment could be inefficient or welfare-reducing or even cause environment pollution. This means that profits through exporting may be the main and only aim of the foreign investor not the benefits of the host country's market. For achieving this goal, foreign investors follow their way in dealing with the Arabic economical problems, for example they rely more on their home country in financing their investments, as a way to avoid bureaucratic administrative procedures, exchange rates, and inflation rates that are widely exist in the MENA economics (Sadik and Bolbol, 2001).

Hence it seems that there is a hidden risk behind the weakness flow of market and efficient seeking FDI in the region. My statistical results may shed the light on this hidden risk; which is not the famous risk that usually pointed to and called "political risk", it is the cultural risk that approves to be the hidden and dominant risk in affecting FDI decision in all the MENA countries in general. The following facts may give some explanations for this phenomenon:

1. The disappointing feelings of the Arab civilians toward their governments. Despite being in possession of massive oil and mineral wealth, the region has seen its average standard of living decline in relation to the rest of the world. The per capita income in the Arabic countries has only grown at an annual rate of 0.5% over the last 25 years, by contrast Eastern Asian economies, despite some political instability, economic cycles and financial crisis, managed a growth rate of 4.1%. Today, the combined GDP in all Arabic countries is less than half of Spain.
2. The high level of corruption on both the governmental and the legislation institutions have deeply hurt the economical structure; that many of the reforms were poorly thought through or fell victim to the an inefficient administration and corruption. This has pushed the civilians to look for alternatives to their governments.
3. The intensive efforts of the Western countries presented by United States in imposing the democratic process in the Middle East countries (the New Middle East Model), though stimulating their kind of democracy (like elections, human rights, and woman rights), and force it on the Middle East countries without considering and caring of the Middle East's cultural characteristics and religion standings, the failure of the American democratic experiment in Iraq can be a good example for that.
4. The cultural differences between Western and Eastern countries, especially the Western misunderstanding to Islamic religion basics have unfortunately played a great part in increasing the cap between the two civilizations. For example, what is called in the Western countries "freedom of speech and press" is crossing the red lines and steeping on the "religion fundamentals" according to the Eastern definition. For example the Denmark press freedom on 2005-2006 caused great humiliation to the Islamic religion, which raised the political tension between Arabic countries and Europe and pushed the former to economically break the Denmark products.

ism movements in the Middle East countries (such as at predominant on the national identity, as in the case of Iraq, Iran, Saudi Arabia, Syria, and Lebanon have also pushed the civilians to search for alternative to solve this problem.

6. The high level of masculine in the Middle East countries. It is known that the masculine values assertiveness, aggressiveness, and materialism tend to associate with higher degree of corruption than do the feminine values; which tend to be social (Hofstede, 1997). For example, in Saudi Arabia (the most Middle East country that attracts FDI) women do not have any political rights and are excluded from any decision making in any aspect in the country.
7. The above facts have managed to raise the Islamic movements as a way of expressing the inside anger. The present and the future indications are toward the increase of the Islamic movements and raise their role in the Arabic parliaments as in Egypt, and even reaching the government chare as in Iran and Palestine
8. As soon as the Western countries have manage to spread their kind of democracy on the Middle East through elections, the Arabs have immediately responded and took advantage of the first democratic opportunity and went to what is called ñpunishment electionsò by electing the Islamic groups. This may be not because civilians believe their ideologies but because such groups were the only parts who are wearing the costume of change. In other words the Arabs have used the democratic elections as a punishment tool for their governments, sectarianism movements, and the West regime.

It can be concluded that the above aspects among others have expanded the grey area between the cultural and the political risks in the Middle East countries, and it seems that cultural risk leads to political risk especially that in some cases both of the risks are taking the same level in affecting FDI decision (as approved by the variance decomposition result). Cultural risk in the past was not playing a major role in the foreign investorôs calculations, but the present and future indications are suggesting the predominance of cultural risk on other kind of risks. According to the UNDP (2002) cultural risks seems to be the reason for the fact that MENA countries attracted less than 1% of global FDI and only 4% of FDI directed to the DCs.

Practical experiences approved the ability of foreign investors to deal with political and economical risks as long as their risk-adjustment rate of return is high as in the case of Ghana. But when it comes to the cultural threats that are expanding, foreign investors need to reconsider well his motives in investment strategies in the Middle East before starting with the practical movements - regardless the country his is targeting- (Mmieh and Frimpong, 2004).

The future signs also hint that cultural risk is a contagion ñdiseaseò that could be extremely spread in all the MENA countries, this may remove the shadow from the mysterious phenomenon exists in some of the MENA countries that despite they are characterized with political stability (like Oman, Qatar, Morocco, and Yemen) or with economical stability (like Bahrain and Kuwait), they suffer from a fragile FDI inflows.

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