

Evaluation of the Libyan experience to attract FDI to Libya over the past decade 2000 - 2011

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In the late nineties and the beginning of the third millennium, Libya has started numerous attempts to reform the economics and political system, and began to give up control of the State on the economy, as well try pushing the local private sector and foreign to participate in economic activity. The Libyan authorities has adopted numerous actions to benefit from reform policies, in order in try to encourage private sector to gain lion share in the Libyan economy by privatising large number of public institutions. In addition, Libya updated legislation a number of laws to encourage and attracting investors to invest in Libya. Despite these attempts, Libya did not achieve the desired goals due to various reasons. This paper is an attempt to evaluation the Libyan experience to attract foreign direct investment to Libya over the past decade 2000 – 2011, through survey of authorities actions to achieve reform's targets, and spotlight to what extend Libya has benefited from reforms in side of attracting FDI .

Keywords: Libya, FDI, Reform

1. Introduction

Libya is one of most countries should be benefit from foreign direct investment, while it has a lot of different natural sources, suitable geographic location, and Libyan people has ability to deal with others.

after Libya has gained its independence in early 1950s started build base of trade and economic exchange with rest of world, in particular with USA and Western Europe, this communicate generated economic growth, prevalence of education, deep-root of civil society, and built civilized cities, moreover, oil has been discovered which was basic element to attract FDI in the beginning.

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when Libya adopted socialism regime, after the upheaval in 1969 doors closed front of foreign investors then local investors. Socialism thoughts dominated on all activities in Libya in the second half of 1970s, even exaggerated, till prevented private sector from participated in society actions.

Moreover, Libya involved in many political problems in 1980s, so Libya has faced sanctions because of political issues; the USA hurried to impose sanctions on Libya in 1982; (despite the attempts of US business groups, led by oil companies that hold concessions in Libya to persuade the US administration to ease a trade ban that was imposed on Libya in 1986). The UN Security Council imposed sanctions on Libya in 1992 to press Tripoli to hand over two suspects wanted for the 1988 bombing of a US Pan American Airways airliner over Lockerbie, Scotland.

These sanctions put Libya in severe circumstances, and this led to economic shrinkage in all economic sectors and a development recession. This harmful economic situation affected the Libyan economy.

These difficult circumstances make Libya asked foreign assistances. Therefore Libyan authorities take forward step to attract foreign direct investment, and tried to inflow it into country to refreshing the economy.

2. Literature Review

At the beginning should we address the definition of foreign direct investment, and this is not an easy, whereas many economists and institutions have formulated many definitions including the following: (MacManus, 1972; Ragazzi, 1973; Meyer, 1988; Barrell et al, 1997; Stephan, 1998; OECD, 1999; Ngowi, 2001; Bitzenis, 2002; Borrman, 2003; UN, 2003; UNCTAD, 2004) studied the concept of investing abroad and in particular foreign direct investment. These definitions are not simple definitions in a few lines since they involve much more than simple money transactions that aim to achieve a profit. Might be the most important ones; the definitions of the IMF and the OECD, both emphasize a “lasting interest” and a significant degree of influence of the investor over the company. This “lasting interest” implies a long-term relationship between the direct investor and the enterprise and distinguishes FDI from portfolio investment. Moreover, a “lasting interest” means that there should be a noticeable influence on management of the direct investment enterprise. (Borrman, 2003: 10-11).

Considering all of the fore mentioned definitions the definition of FDI adopted in this paper is that of the World Investment Report definition: “foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated. FDI may be undertaken by individuals as well as business entities”. (UNCTAD 2004: 345)

Theories based on factors have been developed to explain FDI. These factors, which affect FDI, are:

2.1 Political Risk and country Risk

Political instability discourages inflows of FDI. Unexpected modifications of the legalisation and fiscal frame-works in the host country lead to Political risk, which may give negative results to the investment goals. (Wang and Swain (1995), Holland and Pain (1998), and Woodward et al (1997)). In general, they conclude that the main factors, which have driven FDI in transition countries, have been: a need to secure market access; opportunity to participate in large- scale privatization processes; and the degree of political and economic stability. Wang and Swain (1977) tested the relative importance of independent variables, including political stability, the results shows that foreign investors prefer political stability and a free market system (Wang and Swain, 1977).

Stevens (2000) makes an attempt to integrate a number of political and other non-traditional economic variables into a standard theory of FDI based on the maximization of expected value. The empirical results showed that the generalized model that contains additional variables is superior to the conventional model in explaining US FDI in Argentina, Brazil, and Mexico. The results identify that some of the non-traditional variables to affect FDI were subsets of the political stability variable. For example 'specific governments that appear hostile to FDI from the USA' and 'the number of years a government is in power' as well as 'pertinent legislation' and the 'debt crisis' were tested variables. (Stevens, 2000).

2.2 Tax Policies

The incentive to engage in FDI is affected by domestic and foreign tax policies, and the means by which it is financed. Jun (1989) identifies three channels through which tax policies affect the decisions taken by MNCs. First, the tax treatment of income generated abroad has a direct effect on the net return on FDI. Second, the tax treatment of income generated at home affects the net profitability of domestic investment, and the relative profitability of domestic and foreign investment. Third, tax policies affect the relative cost of capital of domestic and foreign investment. Jun (1989) also shows, by using an intertemporal optimization model that an increase in domestic corporate tax rate leads to an increase in outflows of FDI. Slemrod (1989) examined the effect of host country and home country tax policies on FDI in the USA and the results obtained indicate that increases in the US tax rate have a negative effect on FDI. Hartman (1985) concluded that the domestic tax rate on foreign income and the presence or otherwise of tax credits should be irrelevant to a mature foreign subsidiary.

Studies have been conducted to examine the effect of international taxation on FDI (Devereux, 2006). These studies encountered difficulties in identifying the effects of taxes on factor demands of MNCs. Hines (1996) argues that these difficulties are caused by the following factors:

- (i) Cross-sectional variation in national tax rates and tax systems may be correlated with a number of observable and unobservable factors that differ between one country and another;
- (ii) Time series variation in tax rates may not be adequate to identify tax effect, since tax rates change infrequently, and tax changes may be endogenous to unobservable economic conditions that effect factor demands;
- (iii) It is possible that tax policy has no effect, or only a trivial effect, on FDI.

Moreover, Hines (1996) examined a model showing that high tax rates have a significantly negative effect on FDI. Swenson (1994) examined empirically how taxes shape FDI, and found that increased taxes boosted inward FDI, while intuition suggests that higher taxes should discourage both foreign and domestic investment.

As well there are a lot of theories and hypothesis deal with foreign direct investment flows, in this paper will spotlight on incentives which attract FDI, and disincentives that prevent FDI flow

2.3 Trade Barriers

FDI might be considered as an alternative to trade. Therefore, trade barriers such as tariffs have an inverse relationship with FDI. Open economies without much restriction on international trade should receive fewer FDI in or out. Wang and Swain (1995) used a trade-weighted tariff rate to represent trade barriers, but it turned out to be an insignificant determinant of FDI. Yang et al (2000) used the same measure of openness and found FDI flows to be related negatively to the degree of openness of the economy; suggesting that FDI may be used to circumvent trade. A rise in the expected probability of protection from 5 per cent to 10 per cent means a greater than 30 per cent raise in the next period's FDI in or out for an average industry.

2.4 Government Regulations

Governments differ in policies towards foreign investment, some governments encourage FDI, some discourage FDI, and some remain neutral to FDI. Some governments adopt policies aimed at both encouraging and discouraging inward FDI by offering incentives on the one hand and disincentives on the other.

The incentives offered by host governments could be one or more of:

1. Fiscal incentives such as tax reduction, accelerated depreciation, investment and reinvestment allowances and exemption from customs duties. (Onyeiwu and Shrestha, 2005; OECD, 2007);
2. Financial incentives, such as subsidies, grants, and loan guarantees. (Christiansen et al, 2003; Sass, 2003)
3. Market preferences including monopoly rights, protection from competition arising from imports, and preferential government contracts. (UNCTAD, 2004);
4. Low cost infrastructure, fuel, and energy. (UNECA, 2004; PONGSIRI, 2004);

5. The provision of information by means of agencies located in the capitals of the source countries (UNCTAD, 2006);
6. A framework for clear, efficiently implemented stable policies with respect to FDI. (UNCTAD, 2005);
7. Flexible conditions with respect to local equity participation. (UNCTAD, 2005).

2.5 Strategic and Long-Term Factors

Strategic and long-term factors have been suggested to explain FDI. Rueber et. Al (1973) list the following factors as being instrumental to the decision to invest abroad:

1. The investors' desire to defend existing foreign markets and foreign investment against competitors;
2. The desire to gain and maintain a foothold in a protected market or to gain and maintain a source of supply that in the long run may prove useful;
3. The need to develop and sustain a parent-subsidiary relationship;
4. The desire to induce the host country into long term commitments to a particular type of technology;
5. The advantage of complementing another type of investment;
6. The economies of new product development;
7. Competition for market share among oligopolists and the concern for strengthening of bargaining positions.

3. To what extent Libya can attract FDI:

despite of attempts Libya has been did to attract foreign direct investment, and the decisive reason for these failures is the lack of confidence by investors, and when evaluating the Libyan experience in attracting foreign direct investment can note the following:

1. Libya is one of the countries characterised by political stability in the middle east (If we considered period of autocracy is standard of stability), but despite of this situation administrative organisations being characterised by instability due to the political regime has been dominated since 1977, whereas, official officers in all levels changed in short periods, even ministries Integrated sometimes or Eliminated, therefore foreign investors did not trust in this stability, whereof, made them retreat to enter Libyan market.
2. Since 2000, Libya announced to reform the Libyan administrative system and improve its economy to provide an appropriate environment to attract FDI, including abandoning socialism, and opening markets to the private sector and encouraging local and foreign investors. but what is happened is changed

new characters such as Gaddafi sons', likewise their servants which monopolized all kinds of business, and practiced all kinds of corruption, therefore, bribe predominated. in the same time Gaddafi announcing about his intention to continue his regime, that made foreign investors afraid to take foreword step to deal with Libyan government.

3. Libya has followed new orientations; where it tries to attract FDI, by giving advantages to foreign investors by freeing them of tax for the first five years. Moreover, let possible to transfer losses to the next year. Furthermore, Libya established a new law to reform the tax system completely in a procedure targeted to reform the economy. but this is not enough to promote trust from foreign investors in hazy climate circumstances. This as well as reforming the tax system alone under the wretched economic system does not lead to developing any sector in economy in particular in attracting FDI.
4. Libya has not joined GAAT yet, so according to this theory Libya is more attractive for FDI. However, Libya has adopted new commercial policies to reanimate the Libyan economy, such as allowing the private sector to contribute in different economic sectors. but still corruption and bribe play important role in gaining Licenses necessary for the exercise of economic activity, also Libya expressed interest in joining the Organization of GATT, and so when admission to membership in the organization lose this distinctive.
5. Regarding to government regulations in Libya did not happen where any development to keep up with policies to attract investment direct investment, where the infrastructure is poor, and transportation and communications are weak does not meet the requirements of investors, as well did indicate any subsidies or exemptions in the tax production, raw material and prices of energy, as well as the lacking of data and information, and more importantly, the lacking of clear and stable policies that touched FDI.
6. Concerning to long-term strategies, the regime Family prevailing in Libya and the absence of democracy and instability of government departments, and blurry economic climate, all these things to prevent a long-term strategies, so cannot investors develop strategic plans for their projects, and thus no one take risk to enter the country do not know when and how to get out of them, especially in light mood Gaddafi and his sons, and political tension with Switzerland that led to the severance of relations is sufficient evidence for not entering any foreign investor.

4. Recommendations for Attracting FDI

1. Libya should providing appropriate investment climate to attract FDI; while reform one part of economy such as established law to encourage FDI and letting the other legislations in same situation that prevent any liberalization to make FDI move in and out of country freely. so Libya must work to reform economic and political regime;

2. should reform the banking system in Libya, in general, when we revise banking system in Libya will notes that still managing by law No (1) for year 1973. and changes did not happen through this long period, Commercial banks in Libya working under the authority of the central bank as the coffers of money and payment of salaries to people. therefore, economic reform should be start by reforming banking system;
3. Facilitating procedures for the entry of investors and the free movement of money to and from Libya, easy procedures is important factor for attracting foreign direct investment, also, administrative stability and the eradication of corruption, bribery remains the most important factor;
4. Intensify advertising to make new investors know potential investment opportunities in Libya, so you should take advantage of all the media to promote investment, by the other hand facilitate the complex procedures to enter Libya to investors;
5. Gain the confidence of investors through activating and more reforming the laws to be more attract foreign investment, whereas the laws that arrangement Law No. (5) for year (1997) for Promotion of Investment of Foreign Capital, as Amended by Law No. (7) for year (2003), then law No. (9) for year (2010) which has integrated domestic investment and foreign investment and that in itself is a legislative defect might be make the investors take backward step.

5. Summary and Conclusions

Finally, as all know (theoretically) FDI affects both sides, where FDI enters in projects physically, in different modes of FDI, such as J.V (Joint Venture), which more acceptable for most host countries, this gives the opportunity for the host country to benefit from technology transfer, participate in finance of new projects, provide job opportunity for local employment, and benefit from foreign experiences. At the same time foreign investors will open new markets that help them to build new relationships with peoples from various cultures, which will support them to take the next step to enter neighbour countries. Moreover, foreign investors will benefit from raw materials, and may be discover new materials in these unprecedented lands. whoever, despite of Libya attempts to attracting FDI by announcing its intent to attracting FDI without effective confidence procedures, or reform a part of economy while the rest of economy remain suffered. reforming should cover all economic activities but spreads to social and political life.

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