Politica Risk and Foreign Direct Investment in Tunisia: 
The Case of the Services Sector 2004-2016

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ABSTRACT

Political risk factors have been considered as important factors which impact the foreign direct investment (FDI). But, the relationship between the political risk and FDI still not highly covered as expected. In this context, it is crucial to measure the political risk factors impact on the FDI especially for the Arab Spring countries which embraced radical political change after the revolution in 2011. This article aims to investigate the relationship between political risk and the FDI in Tunisia for the case of service sectors. The research is based on aggregate variables that represent six pillars of Governance Indicators. The data was extracted from the Worldwide Governance and the Tunisian Central Bank websites, the data frequency is yearly from 2004 to 2016. The research confirms that the political factors notably the government effectiveness and voice and accountability have significant impact on the FDI and on the FDI in the services sector.

KEYWORDS

Arab Spring, Correlation, FDI, Growth, Political Risk Indicators, Regression Model, Services Sector, Social Revolution, Tunisia

INTRODUCTION

Many researches showed that Foreign Direct Investment, FDI, is one of the principal approaches of “cross-border” investment and one of the most active drivers of economic growth for the host country. Indeed, it contributes to the process of capital formation notably in the emerging countries, particularly through the technologies’ exchange, the business “know-how” exchange (experiences exchange, advising etc.) and the balance of trade’s improving. Also, FDI maintain the employment growth via creating new employment opportunities and setting up new markets (as exports markets). The quality and the cost of the workforce in the host country, the political stability, the security and the rule of law are ones of the factors which can attract or discourage the FDI. So, the factors which may impact the FDI can be resumed into the size and the growth of the host country, as well, the political risk indicators.

The Tunisian economy depends on the services sector and manufacturing industries (such as textiles and car pieces) mainly oriented to exports. To maintain the Tunisian economy, the Tunisian authorities encouraged the FDI, to create new exports markets, to bring new technology, to improve the services sector notably the Tourism and to decrease the rate of the unemployed qualified workforce. Different policies were set up in favor of the FDI such as the investment code (last update was in 2009) and different agencies, such as the Foreign Investment Promotion Agency, were created to

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give support and provide information to the foreigners willing to invest in Tunisia. Based on the last statistics in 2017, FDI presents 10% of productive investments, generates 1/3 of exports and over 15% of the total number of jobs.

However, starting from the global recession in 2008, then the country’s socio-political revolution in December 2010, the FDI declined in Tunisia following the published statistics of the Tunisian Central Bank. The FDI decreased by almost 70.5% between 2006 (maximum FDI volume) and 2011 (minimum FDI volume and the year of the global change after revolution). After the Tunisian revolution, the economic situation collapsed, and the decrease of the FDI volumes after 2011 made the economic situation worse; losing investors, the sources of employment decreased (almost 182 foreign firms left Tunisia in 2011), the unemployment rate climbed (18.33% in 2011) and the growth rate plunged (-2% in 2011).

Accordingly, the main purpose of this paper consists on examining the impact of the political risk indicators on the growth of FDI in Tunisia.

The rest of the paper is divided into 5 sections. Section two is dedicated to the theoretical framework for FDI and the political risk factors. Section three outlines the importance of FDI in Tunisia and notably in the services sector. Section four describes the research methodology and the variables. Section five presents the regression results and summarize the interpretations. The last section, section six, sums up the main considerations and results of the research.

A THEORITICAL FRAMEWORK FOR FDI AND POLITICAL RISK INDICATORS

Foreign direct investment (FDI) could be defined as the direct investment equity flows in an economy. FDI is the sum of equity capital, reinvestment of earnings and other capital (IMF, 2003). It is defined in the World bank as a sort of cross-border investment related to an enterprise or an investor governing or impacting an investment in a foreign country (Worldbank, 2018). Ownership of 10 percent or more of the ordinary shares of voting stock is the criterion for determining the existence of a direct investment relationship (IMF, 2003). Farrell (2008) defined FDI as a set of capital, technology, management, and entrepreneurship, that allows a firm to be functional and to provide goods and services in a foreign market.

Therefore, FDI contributes directly and indirectly to the economic growth of the host countries (Almfrajia & Almsafir, 2013); (Roy & Berg, 2006) by easing the transfer of technological and business know-how (Romer, 1993), augmenting labor training, skill acquisition and diffusion, and the introduction of new managerial practices and organizational arrangements (De Mello, 1999). Solomon (2011) demonstrated that there is a significant relationship between inward FDI and growth and Choe (2003) showed that FDI Granger causes economic growth.

Theoretically, the two most important determinants of FDI are the size and growth of the host country and cost competitiveness (Khan & Ibne Akbar, 2013). Almfrajia & Almsafir (2013) summarized the main findings of the literature reviewed in terms of the determinants of the FDI.

Although, the influencing factors of FDI, have been extensively studied in the literature, one determinant of FDI has not been largely discussed so far which is the political risk. Stoychev (2013) showed that in the literature review, the political risk was defined as the probability of the financial losses imposed on the foreign investors in a political regime. Consequently, as provided in the works of Howell (2001), Brink (2004) and McKellar (2010), the political risks were explained only by the wars, the radical system changes such as the revolutions or the natural disasters.

As a matter of fact, the extent of the flow of foreign direct investment is highly dependent on the political atmosphere of the host country, it should be the case that political risk would have a negative impact on FDI, political instability increases uncertainty in the economic environment and discourages the foreign investments (see also (Aguiar et al., 2012) and the sources sited there).

The question to be raised here is how to measure the impact of the political risk on FDI?
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