The Arab Spring
Implications for Economic Integration

Edited by Michael Gasiorek

FEMISE CEPR

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The Arab Spring: Implications for Economic Integration

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Foreword

This volume, the 19th in the VoxEU eBook series, draws together the reflections of a group of distinguished scholars and specialists on the role of economic integration for the countries of the MENA region. The timing is apposite bearing in mind the dramatic changes in these societies, the ongoing changes in the world economy, and also the pressing economic and social need for higher rates of economic growth in the region. The volume includes two types of contributions: country-specific analyses from leading country experts on Egypt, Morocco and Syria; and more formal cross-country analyses which take a broader perspective on the role of trade and integration.

The aim of this volume is both to identify the key changes that are taking place and also to provide policy relevant insights and advice to the MENA region. There are several common themes that emerge in the volume. The first is contextual and identifies the relatively low growth rates and relative lack of export success/dynamism of most of the countries in the region.

A second theme focuses on the importance of trade and integration in improving the competitiveness of the countries of the region and, through that, impacting on their capacity for economic growth.

Third, the authors highlight the close interface between appropriate institutions, regulatory frameworks and infrastructure, and international integration. Trade liberalisation or regional integration alone will not provide a simple panacea for the economic, social or political difficulties in the region. Trade liberalisation requires the right environment in order to be effective, but liberalising trade can in turn help to create better incentives for appropriate reforms.

Fourth, to be effective, trade liberalisation needs to involve much more than reductions in tariff barriers. Each of the contributions identifies a range of non-tariff measures/ barriers which impede the degree of integration and which need to be addressed.

The final theme that emerges strongly is that achieving any of the above requires the domestic political will to introduce reforms, to provide better incentives for investment and private sector activity, and to reduce corruption. As evidenced by the first three chapters in the volume, this is a formidable challenge, the precise nature of which varies enormously across different countries. However, without the political will and without the necessary reforms, progress towards sustained higher growth rates supported by closer trade and integration will be unlikely.

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1 Introduction and summary

Michael Gasiorek
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Key changes are taking place in the world economy. These are in part a function of the economic crisis of 2007-09 and its ongoing repercussions, but are probably more fundamentally a result of significant structural changes taking place within economies and, in consequence, between economies. These changes are well documented elsewhere and range from the rise in the importance of countries such as China, India and Brazil in world trade to the changes in the nature of supply-chain relationships between countries and the rise of vertical fragmentation. In turn, these changes have significant implications for the role and domain of economic policy – again both at the national level and also at the international level. Focusing on trade policy, at the national level we have seen some significant declines in tariffs over the last 10-15 years as well as progress on other barriers or obstacles to trade typically referred to either as non-tariff barriers (NTBs) or non-tariff measures (NTMs). At the wider level, we have seen the ongoing stalling of the Doha Round in the WTO and numerous discussions on the possible future and role of the WTO. Concurrently, we have also seen the ongoing process of regional integration taking place with initiatives all round the world ranging from discussions on the Tripartite Agreement in Africa, to the Trans Pacific Partnership Agreement, as well as the possibility of an EU-US agreement. All this is also in the context of the consequences of the financial crisis of 2007-09, the ongoing crisis in Europe, and the significant slowdown in economic activity in across many countries of the world.

Within this broad picture, there are some deep and fundamental changes taking place in the Middle East and North Africa (MENA) region. In particular, the Arab Spring, as it has come to be known, has directly resulted in dramatic political and economic changes in Tunisia, Egypt and Libya, and in the ongoing and rapidly deteriorating situation in Syria. As a result of this other countries, such as Morocco, Jordon and Algeria, have also introduced policy changes. The aim of this publication is to bring together some reflections, from a group of distinguished scholars and specialists, on these developments and on the role of international integration and the potential importance of international trade for the countries of the MENA region. The timing is apposite bearing in mind the dramatic changes in these societies, the ongoing changes in the world economy, and also the pressing economic and social need for higher rates of economic growth in the MENA region, especially given the demographic changes taking place and the consequent rise in young people entering the workforce.

The contributions in this volume are of two types. The first part of the volume contains three country-specific analyses from leading country experts of the process of change and transformation that is currently taking place. The authors provide their thoughts on the processes taking place and on the importance of different policy initiatives. There are chapters by Ahmed Ghoneim on the transition process in Egypt, Mouna Cherkhaoui on the changes taking place in Morocco and on the importance of Maghreb regional integration, and from Raed Safadi on the options for Syria. The chapter on Syria predates the current troubles but is nevertheless highly pertinent both as a powerful summary of development leading up to the current situation, but also as a pointer to the future when eventually there is some resolution to the tragedy currently unfolding.

The second part of the volume includes contributions which are more cross-country in nature and take a broader perspective on trade-related issues. These include chapters by Caroline Freund and Portugal-Perez, who assess the effects of preferential trading agreements on trade in the region, Patricia Augier, Olivier Cadot, Julian Gourdon and Mariam Malouche, who provide a detailed analysis of non-tariff measures in the region, and Jean-Pierre Chauffour and Bernard Hoekman, who identify a range of policy areas they suggest the region should focus on in order to stimulate more trade and investment, greater integration in supply chains and, as a result, higher growth rates.

It is of course important in the first instance to underline that though there are some cultural, political, social and economic similarities across these countries, they also vary widely. Hence, one should be cautious in trying to apply specific recommendations and conclusions without a careful appreciation of the context. Some of those differences can be seen in Tables 1 and 2 below, which provide some selected World Development Indicators for the countries of the MENA region for which data was available, plus some selected other countries for comparison.

Table 1 Selected World Development Indicators: 2010

Country	GDP per capita (constant 2000 US$)	FDI net inflows % of GDP	Ease of doing business	Agricult. VA % of GDP	Industry value added % of GDP	Manuf. value added % of GDP	Services value added % of GDP
Algeria	2,231.98	1.40	143	6.92	62.12		30.96
Egypt	1,975.55	2.92	108	13.99	37.53	15.80	48.48
Israel	22,239.05	2.37	32				
Jordan	2,579.38	6.44	95	3.42	30.72	19.16	65.86
Lebanon	6,745.65	10.97	103	6.38	21.45	8.33	72.16
Morocco	1,844.35	1.36	115	15.37	29.66	15.29	54.96
Syria	1,525.81	2.48	136	22.93**	30.59**		46.47**
Tunisia	3,143.53	3.17	40	8.01	32.28	17.97	59.72
Turkey	5,356.00	1.24	73	9.60	26.65	17.70	63.75
Brazil	4,716.61	2.26	120	5.30	28.07	16.23	66.63
China	2,426.33	3.12	87	10.10	46.67	29.62	43.24
India	794.80	1.43	139	17.74	27.12	14.54	55.14
Czech Rep.	7,802.86	3.10	70	2.40	37.65		59.95
Hungary	5,633.99	-29.23	46	3.53	31.03	23.23	65.44
Poland	6,574.30	1.94	59	3.54	31.63	18.49	64.83
EU	19,359.33	2.81	40*	1.48	25.53	16.67	72.99
USA	37,329.62	1.64	4.00	1.18	20.00	13.17	78.82

Source: World Bank, World Development Indicators. *Notes*: *data for 2011: ** data for 2009

Table 1 considers a range of economy-wide indicators, while Table 2 focuses on trade-related indicators. With respect to GDP per capita, all of the countries except Syria are above the average for low- to middle-income countries, with Israel not surprisingly being the outlier. Following Israel, Lebanon, Turkey and Tunisia have the highest GDP per capita, and Egypt, Morocco and Syria the lowest. In all cases, except Lebanon and Turkey, GDP per capita is significantly lower in comparison to the EU's new member states. FDI inflows as a percentage of GDP also vary significantly, ranging from nearly 11% for Jordan, to 1.24% in Turkey and 1.36% in Morocco. On average, these figures are not significantly different from those reported for other countries, but of course that average masks significant variation across countries. The last four columns of the table give the shares of agriculture, industry, manufacturing and services in VA as a percentage of GDP, and here too significant differences can be observed. The share of agriculture in GDP ranges from 3.42% for Jordan to nearly 14% for Egypt and 23% for Syria; the share of services ranges from just over 72% for Lebanon, to 66% for Jordan and to 31% for Algeria.

Table 2 Descriptive statistics on trade

Country	Customs & and other import duties (% of tax revenue)	Taxes on international trade (% of tax revenue)	Exports of goods and services (% of GDP)	Imports of goods and services (% of GD)	Share of tariff lines with international peaks	Tariff rate applied simple average
Algeria			30.83	21.50	53.18*	14.18*
Egypt	8.05	4.85	21.35	26.13	18.44*	12.6*
Israel	1.39	0.91	36.87	34.92	2.93*	5.95*
Jordan	9.22	6.13	47.79	69.03	29.54*	9.73*
Lebanon			20.95	43.78		
Morocco	6.85	5.55	33.00	42.92	23.59*	9.13*
Syria			35.33	35.76	27.56	6.66
Tunisia	8.83	6.19	48.76	54.07	57.77**	21.88**
Turkey	1.49	1.25	21.21	26.76	5.35	2.53
Brazil	3.67	2.14	10.87	11.90	26.43	13.44
China			29.55	25.64	11.17	7.74
India	15.01	12.82	22.77	26.92	10.44**	11.5*
Czech Rep.	0.00	0.00	67.86	64.67	1.86	1.94
Hungary	0.00	0.00	86.55	80.04	1.86	1.94
Poland	0.72	0.39	42.25	43.45	1.86	1.94
EU		0.02	39.78	38.84	1.86	1.94
USA	2.11	1.16	12.73	16.31	3.42	2.90

Source: World Bank, World Development Indicators. *Notes*: *data for 2009; **data for 2008

If we turn to Table 2, we also see considerable variation with regards to trade-related indicators. The first two columns consider the share of customs and other import duties, and the share of other taxes on international trade. We see that these are comparatively high in Egypt, Jordan, Morocco and Tunisia, while they are low in Turkey and Israel. Perhaps not surprisingly, a similar pattern emerges when looking at the share of tariff lines with international peaks, and the differences in tariffs across the MENA countries reported here. These figures are also considerably higher than those in the EU or the US, as well as in the EU's new member states listed in the table. We also see substantial differences in the share of exports and imports as a percentage of GDP. Egypt has the lowest share of exports (21.35%) and the second lowest share of imports (26.13%), while the highest shares are for Jordan (47.79% and 69.03%, respectively), and Tunisia (48.76% and 54.07%, respectively). These figures serve to underline that while there are clear differences across the MENA region, the summary statistics suggest that in a number of countries there remain significant obstacles or barriers to international trade. The issue of the barriers – be they border barriers such as tariffs or other taxes, or behind the border barriers or measures – are taken up in different ways by each of the contributions to this volume.

In the first part of this volume, the first three chapters focus on assessing the transition and challenges in three individual MENA countries. Ghoneim assesses the challenges facing Egypt from a political economy point of view. He does so by providing both a fascinating historical perspective on the challenges currently facing Egypt and also insightful comparisons with the reform process which had been undertaken in Central and Eastern Europe. He then goes on to provide a careful account of the current difficulties facing the Egyptian economy and proposes a series of areas which he believes policy should focus on. In a similar vein to Ghoneim, Safadi provides a historical perspective on the parallel economic and political developments in Syria, with a scathing critique of the policies pursued by the current regime, and he too suggests a series of key policy measures. Cherkaoui outlines the changes that have occurred in Morocco in response to the revolutions taking place elsewhere, and focuses on the potential importance of closer Maghreb integration for Algeria, Libya, Mauritania, Morocco and Tunisia.

While noting the need to recognise some fundamental differences with the countries of Central and Eastern Europe, Ghoneim identifies some key lessons to be learnt from their experiences with transition. These lessons concern the potential importance of remittances, the need to balance social and economic concerns and the difficulty of doing so if reform is undertaken too rapidly. The issue of the pace of reform is also addressed by Safadi, who also warns against too rapid a process of change and transition and of the need to carefully pace and sequence reforms. In addition, Ghoneim perceptively cautions again setting expectations unreasonably high. Both Ghoneim and Safadi argue powerfully for the overriding need for effective institutions and governance mechanisms to manage and facilitate the coordination of policies and to deal with corruption. Both stress the importance of integration in the world economy via both trade and investment.

Ghoneim describes the evolution of the dominant role of the state in the organisation of the Egyptian economy, and the emergence of crony capitalism and corruption and the social contract that sustained it. Having described the conditions and process which led to the revolution and the rupture of that social contract in particular with respect to the youth, Ghoneim then provides some detailed policy suggestions and a framework for the structure and organisation of the Egyptian economy. He suggests, as does Safadi in the context of Syria, that the way forward has to be through developing a liberal free market economy with appropriate institutions and governance structures which are appropriately enforced, and a reduced role for the state, while ensuring social equity. In order for this to be achieved, the economy must be shielded from corruption by significantly strengthening the regulatory regime and through an appropriate balance of incentives between private and social returns. Ghoneim argues that integration with the world economy is a key part of the solution to improving the Egyptian economy through enhancing the competitiveness of Egyptian products in foreign markets, while benefiting from foreign investments and products imported in the domestic market.

With regard to trade and integration, Ghoneim identifies the following priority areas: the need to promote foreign direct investment; a focus on small- and medium-sized enterprises (SMEs); the better marketing of Egyptian products; and improving trade finance and in particular the role of the Export Development Bank of Egypt.

With regard to SMEs (which represent nearly 99% of the non-agricultural private sector, 75% of the labour-force and value-added in the private sector), he suggests that policy should be focused on improving their integration into value chains, and through this into exporting. More broadly, it is also argued that successful penetration of foreign markets increasingly relies on value chain activity, understanding forward and backward linkages and the possibilities for exports therein. The difficulties preventing Egypt from more successful engagement in such activity relate to the poor regulatory environment as well as to difficulties in access to finance, the lack of the appropriate information, knowledge and expertise, and the size of the informal sector. Ghoneim calls for the ongoing integration of Egypt into the world economy not only via closer regional integration, but also through improving trading links with South East Asian countries and the BRICs[1]. He notes, however, that regional integration is highly impeded by the proliferation of non-tariff barriers.

Safadi's analysis of the situation in Syria starts from the premise that meaningful political and economic freedoms are inseparable, and that the political "awakening" which is taking place needs to be combined with economic transformation. The economic management of the two Assad regimes was highly centralised, dirigiste and corrupt, with a heavy reliance on state planning, import substitution policies and nationalisation of private and foreign assets, a strong dependence on volatile oil markets, limited private sector activity and employment creation, a weak bureaucratic business environment, and declining integration into the world economy. While there were some attempts at reform, in reality these were limited. Safadi notes the relative isolation of the Syrian economy from global markets for goods and services arising

1 Brazil, Russia, India, and China.

from high tariff and non-tariff barriers, and an opaque and complex web of protection that severely distorts economic incentives.

Safadi argues that the transformation of the Syrian economy should be based on the free market, an appropriate regulatory environment, an education system matched to the evolving needs of the Syrian economy, and flexible labour market policies – all with the objective of enhancing productivity and competitiveness and enabling private-sector led growth. This should be coupled with an open and transparent trade and investment regime in order to encourage integration in regional and global markets for goods, services and ideas. That integration into world markets is essential to enable firms to exploit their comparative advantages, broaden the quality and range of goods available to consumer and firms, and to allow for the diversification of risk and the efficient channeling of capital and resources.

Similarly to Ghoneim, Safadi argues that while an open economy is essential, it can only be achieved through appropriate complementary policies, and that "the positive results from an open economy are not automatic; other policy choices matter as well". Building on the work of Rodrik, he argues that fundamental here is establishing sound economic governance built on strong institutions and protected by rule of law, which should focus on property rights, regulatory institutions, institutions for macroeconomic stabilisation, social insurance, and institutions to manage social conflict.

The issue of closer regional integration is considered in some detail in Cherkaoui's chapter. She argues that closer Maghreb integration, through the Arab Maghreb Union (AMU), would serve to increase the attractiveness of the Maghreb countries to foreign direct investment, could provide an increased market for exports through an improved business environment which would allow firms to import cheaper/higher quality intermediate inputs, and help them take advantage of economies of scale. In turn, closer regional integration could help to make the member states more competitive and hence improve their exports to third markets. The argument, therefore, is that in some sense regional integration can be seen as a stepping stone towards closer integration with world markets.

Closer integration could also help security and stability in the region as a result of the heightened common interest in the region and of the attendant rise in growth and employment. Finally, Cherkauoi also argues that closer regional integration would help to shield the region from external shocks. She suggests that the events of the Arab Spring provide a strong political imperative towards closer integration in the region and that increased moves towards democracy and the participation of society in the reform process will inevitably be linked to a desire for closer regional ties. Conversely too, closer Maghreb integration will only be possible if countries introduce institutional, regulatory and political reforms. She discusses three specific sectors – energy, transport and banking and insurance - where some degree of integration in the Maghreb has been achieved.

Primarily in the context of Morocco, Cherkhaoui then considers in some detail the steps taken towards closer AMU integration and the possible reasons why progress towards this has been slow. The picture that emerges is that, despite meetings and consequent statements from regional leaders in favour of closer Maghreb integration, the de facto pace of reform has been slow. This appears to be in part because the process is simply seen to take a long time, in part perhaps because capacity has been diverted to negotiating and implementing other agreements such as with the EU, and in part ultimately due to a lack of sufficient political will. This highlights an issue which is common to all of the contributions in this volume, which is that closer integration can only be achieved if the political will is there within each country and between countries.

The lessons from integration with the EU provide an important backdrop to discussions for greater Maghreb regional integration. The Association Agreement with the EU which has gone much deeper than simple tariff reform has, according to Cherkaoui, strengthened and deepened trading relations between Morocco and the EU, and has helped to introduce much needed changes within Morocco to improve its business practices and competitiveness. All this has involved "a profound transformation of the economy and of society" with both costs and benefits. An important lesson to be learnt from this process, however, is that effective integration takes a long time to achieve, has many dimensions involving much more than tariff liberalisation, and should be introduced progressively. There is also an interesting tension raised in the chapter between the gains from integration with Europe and the lessons learnt, and the consequent diversion of resources away from greater Maghreb integration

Cherkaoui also considers other regional integration initiatives in the MENA region, such as GAFTA/PAFTA and Agadir. The relatively limited success of GAFTA and, to some extent, Agadir are in part attributed to weak dispute settlement mechanisms, the presence of high non-tariff barriers to regional trade and poor infrastructure, but also to the fact that these agreements have largely focused on tariff barriers and have failed to provide for deeper integration initiatives dealing with behind-the-border barriers.

The importance of deeper integration, behind-the-border barriers and non-tariff measures is a key issue which emerges from the second part of the volume, in the chapters taking a cross-country perspective. Chauffour and Hoekman stress the importance of economic integration for the MENA countries both with their neighbours but also with the world. They argue that such integration is central to sustained economic growth for the region. Similarly to Augier et al., they argue that the small relative size of the MENA countries/region effectively means that they face almost unlimited external demand for their products; and similarly to Freund and Portugal-Perez they suggest that the focus should be on more than just regional integration. The importance of the role of integration and trade is also stressed by the respective country contributions focusing on Egypt, Morocco and Syria.

To provide a backdrop to these issues, Table 3 looks at the direction of MENA countries' trade. The table gives the share of MENA exports going to four destinations since 1996[2].

2 MENA comprises the following countries for which data was available: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia and Turkey.

What can be easily seen is the decline in the share of exports going to the EU from over 52% to just over 43% (and this is despite the Barcelona process), a small reorientation of trade towards the MENA region, and a more substantial reorientation towards the rest of the world. Despite the decline, the importance of the EU as a trading partner emerges strongly, with over 40% of MENA exports going to the EU in 2010.

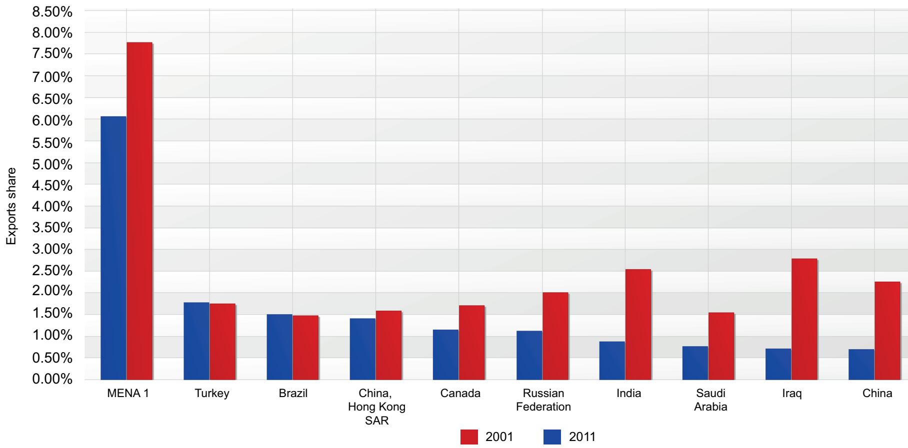
Table 3 MENA Export Shares by Destination

Partner	1996	2000	2005	2010
EU27 Members	52.69%	51.77%	50.86%	43.28%
MENA	7.07%	6.53%	6.59%	9.90%
Rest of the World	26.00%	23.60%	26.17%	33.79%
USA	14.24%	18.10%	16.39%	13.03%

Source: TradeSift calculations on the basis of Comtrade data via WITS

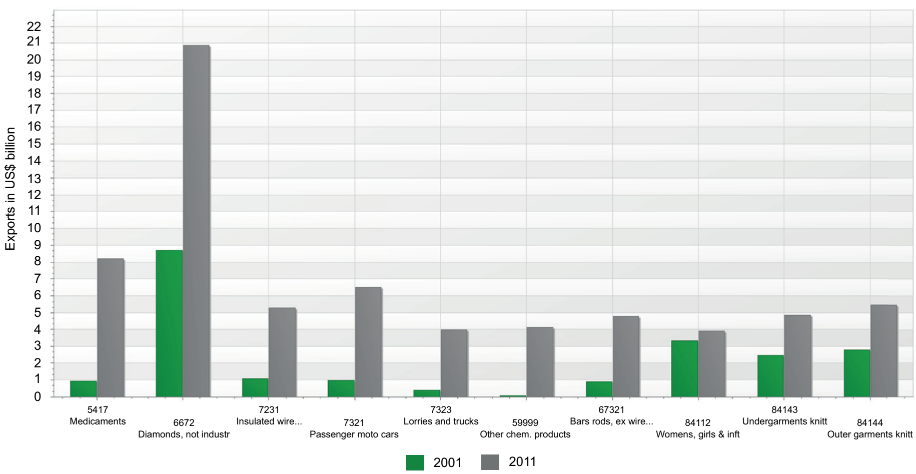
Figures 1 and 2 provide some more detail by decomposing the change in exports for the MENA region both by destination and by key products exported over the period 2000-11. Figure 1 focuses on the region's most significant export markets, excluding the US and the EU. From the figure, it can be seen that as well as increased MENA trade, there is an expansion of trade to a range of countries, with the biggest increases taking place with China, Iraq and India, and more modest increases elsewhere. Figure 2 then considers the changes in the exports of the top 10 SITC 5-digit products (excluding oil, gas and special transactions) exported by the MENA region over the same time period. Here we see the biggest changes taking place with respect to passenger motor cars, medicaments and insulated wire and cables.

Figure 1 MENA share of exports to top ten destinations, 2000-10



Source: Comtrade via WITS Total Trade.

Figure 2 Change in top ten MENA exports, 2000-10



Source: Comtrade via WITS 5-digit.

In the above analysis, the MENA countries were treated as a single grouping – yet there are considerable differences between them in size, structure, and trade. Those differences can be seen in Table 4, which considers the trade intensity index (TII) for individual MENA countries, as well as selected other countries. The TII calculates the extent to which a given country's trade is oriented towards a particular partner country or region in comparison to the rest of the world. When the indicator is greater than one, this suggests that trade is more regionally concentrated with that partner than the world average, and hence that the country's trade is biased towards that partner.

Table 4 Trade Intensity with the EU and MENA

	EU			MENA		
Reporter	2000	2010	Change	2000	2010	Change
MENA	1.14	1.11	-0.02			
Egypt	0.79	0.73	-0.06	3.41	7.50	4.09
Israel	0.75	0.73	-0.01	11.29	5.16	-6.13
Jordan	0.15	0.11	-0.04	7.26	7.90	0.64
Lebanon	0.63	0.66	0.03	2.32	3.27	0.95
Morocco	1.89	1.75	-0.13	1.17	1.73	0.56
Palestinian T.	0.01	0.07	0.06	38.13	30.25	-7.89
Syria	0.62	0.15	-0.46	8.84	8.27	-0.58
Tunisia	2.01	1.99	-0.01	3.31	4.17	0.86
Turkey	1.47	1.37	-0.10	3.28	3.39	0.11
Brazil	0.73	0.64	-0.09	0.76	1.25	0.49
China	0.42	0.55	0.13	0.65	0.81	0.16
India	0.62	0.45	-0.16	0.74	0.90	0.16
Rep. of Korea	0.37	0.32	-0.05	0.83	0.96	0.13
Czech Rep.	2.17	2.30	0.13	0.53	0.63	0.10
Hungary	2.07	2.05	-0.03	0.51	0.85	0.34
Poland	2.06	2.25	0.20	0.68	0.78	0.10
EU27 Members	1.65	1.75	0.10	1.38	1.24	-0.14
USA	0.56	0.53	-0.03	0.95	0.91	-0.04

Source: TradeSift calculations using Comtrade via WITS data, based on SITC 3-digit data.

The left-hand panel of the table gives the TII for trade with the EU, and the right-hand with the MENA region. What clearly emerges from the table is that while in aggregate the MENA region is indeed oriented towards the EU, this is driven by the trade of three countries – Morocco, Tunisia and Turkey. For each of the remaining economies, there is no evidence of bias in trade towards the EU. Also noticeable, as noted earlier, is the decline in the orientation of trade towards the EU. Conversely, we see that for the Czech Republic, Poland, Hungary and the EU, there is a strong orientation towards intra-regional trade. Turning to the right-hand panel, we see that all the MENA countries have a bias in their trade towards the MENA region, and in all but three cases (Israel, Palestinian Territories and Syria) there has been in increase in that orientation.

The issue of the regional intensity of trade and the role of trade preferences in promoting such trade is considered more formally in the chapter by Freund and Portugal-Perez. As they state, this is in the overall context of the MENA region under-trading by between 60-70% compared to its potential, and with comparatively low levels of diversification. The conclusion which emerges from their gravity-modelling based approach is that, overall, the impact of preferential trade agreements has been negligible and that “current trade agreements have not stimulated trade in a meaningful way”. They find that for the Agadir Agreement and the US-Jordan agreement, there is evidence of a positive impact commensurate with that found for standard PTAs, while for all the other agreements such as GAFTA, EU-MENA and Turkey-MENA this is not the case. It is interesting that despite the Barcelona process, there is no evidence that the agreements with the EU have stimulated more trade.

These results regarding the impact of preferential trading agreements appear to be lower when compared with the impact of “deeper” preferential trading agreements, notably the EU. This leads the authors to conclude that for the regional preferential agreements to have a more significant effect, they need to be deeper. This entails focusing on issues such as improved governance, regulatory harmonisation, labour mobility and services trade. However, while arguing for deeper regional integration, they also caution however against an overly strong focus on regional integration alone, arguing that gains and the possibilities for involvement in supply chains will be more substantial from integration with countries outside of the region. They also note that for such deeper integration to be feasible the domestic political will for such changes is also necessary

The issue of deeper integration is taken up in the chapters by Augier et al. and by Chauffour and Hoekman. The fundamental premise underlying the work of Augier et al. is that the world market has become much more competitive through the rise of countries such as China, India, South Korea and that it has become harder to access markets competitively. They suggest that a particular issue for the resource-poor Mediterranean countries is that they are neither labour abundant nor skill abundant, and therefore find it hard to compete with countries which have either of these advantages.

The issue of competitiveness, both in countries and products, is extremely important. Improved competitiveness allows for gains from specialisation and possible gains from higher growth in productivity. That growth in productivity can come about either through firms becoming more productive (for example, via technology transfer, investment or cheaper/better intermediates), or through firm-level reallocation effects with the contraction or exit of less efficient firms in an industry and the expansion or entry of more competitive firms. Augier et al. and Chauffour and Hoekman, as well as Ghoneim with respect to Egypt and Cherkaoui who focuses on Morocco, suggest that integration can be an important facilitator of this process.

It is interesting therefore to consider the changes in competitiveness even over the last five years for the MENA countries (Tables 5 and 6), and in each case for their top 20 exports. By way of comparison, the tables also include selected other countries. In first column of Table 5, we list the share of each country's top 20 exports in their total export to the world. This gives some indication of how specialised/diversified each country is. For example, 20 products (out of a total of 1155) account for over 70% of the exports of Israel, Jordan, Morocco and the Palestinian Authority. This suggests a high degree of product concentration, which in turn suggests that any changes in competitiveness could have a substantial impact on these countries' trade. It also suggests that changes in competitiveness could have more substantial political economy implications on the affected sectors.

Table 5 Change in competitiveness for the top 20 MENA exports (SITC 5-digit data)

		Decline in revealed comparative advantage	
Country	Export Share	2005 industries	2010 industries
Egypt	43.66	14	15
Israel	70.8	11	6
Jordan	74.44	11	6
Lebanon	57.39	16	11
Morocco	72.36	16	14
Palestinian Authority	77.45	16	6
Syria	36.15	12	4
Tunisia	55.63	15	13
Turkey	43.82	10	7
Brazil	54.23	16	15
China	48.37	10	8
India	56.64	16	10
South Korea	67.84	9	6
Czech Republic	51.15	9	8
Hungary	62.54	10	6
Poland	43.74	11	8
EU27	41.44	8	7
USA	46.1	13	11

Note: all calculations are excluding oil and gas.

Source: TradeSift calculations on the basis of Comtrade data via WITS.

In column 2, we report on the number of 2005 SITC 5-digit industries for which there has been a subsequent decline in revealed comparative advantage. For each country, we have calculated the standard Balassa indicator of revealed comparative advantage (RCA) for the top 20 products (excluding oil and gas) exported in 2005. We have then calculated the RCA for the same industries in 2010. The column then gives the number of industries for which the RCA shows a decline. So, if we look at the entry for Egypt we see that out of the 20 industries which were Egypt's most significant export industries in 2005, Egypt subsequently experienced a decline in its revealed comparative advantage for 14 of these. Across the range of MENA countries, we see that the number of industries experiencing a decline in the RCA is not substantially different, though on average slightly higher than for the remaining countries in the table. Column 3 performs an identical analysis but in this case we take the top 20 industries exported in 2010 and consider their evolution of comparative advantage between

2005 and 2010. This is because if there are structural changes taking place, leading to changes in competitiveness, one might expect that industries which are currently the most important would be less likely to experience a decline in revealed comparative advantage. This is true for all countries in the table, and notably so for Israel, Jordan, the Palestinian Authority and Syria. The table also suggests that even over a fairly short time period, there are quite substantial changes in underlying comparative advantage which may be taking place.

Table 6 Changes in export shares

	Based on top exports 2005				Based on top exports 2010			
	2005	2010	% change	Count	2005	2010	% change	Count
MENA	3.23	2.82	-12.89	8	2.81	2.68	-4.64	10
Egypt	0.63	0.34	-46.26	12	0.55	0.50	-9.59	17
Israel	1.78	1.19	-33.07	9	1.37	1.13	-17.47	14
Jordan	0.41	0.36	-14.01	10	0.21	0.19	-10.62	16
Lebanon	0.12	0.13	10.38	8	0.06	0.11	85.27	12
Morocco	0.97	1.07	10.85	9	0.96	1.09	13.54	11
Palestinian A.	0.02	0.01	-40.81	8	0.02	0.03	56.65	17
Syria	0.13	0.14	6.44	12	0.09	0.18	106.48	19
Tunisia	0.49	0.53	7.04	8	0.35	0.33	-7.81	10
Turkey	1.83	1.44	-21.39	10	1.63	1.44	-11.64	13
Brazil	2.99	3.38	13.01	11	2.34	3.21	36.97	15
China	20.16	30.34	50.49	18	14.09	19.64	39.37	19
India	2.74	3.45	26.03	14	2.64	3.78	43.45	18
South Korea	6.69	6.97	4.30	14	6.38	6.98	9.48	17
Czech Republic	1.20	1.51	25.40	15	1.20	1.52	26.65	16
Hungary	1.18	1.22	3.64	10	1.17	1.28	9.79	14
Poland	1.81	1.70	-5.67	13	1.35	1.55	15.04	15
EU27	46.89	41.60	-11.29	1	47.98	42.56	-11.29	3
USA	10.27	9.77	-4.91	7	9.72	10.83	11.33	8

Note: all calculations are excluding oil and gas.

Source: TradeSift calculations on the basis of Comtrade data via WITS.

Table 6 looks at this issue from another perspective. Once again, we have taken each country's top 20 exports – in the left-hand panel this is based on 2005 trade, and in the right-hand panel on 2010 trade. Consider first the left-hand panel. The first two columns give the share of world exports accounted for by the country in question. For example, Egypt accounts for 0.63% of world exports in 2005 in its 20 most significant export products. Egypt's share of world exports for those 20 products then declines by just over 46% to 0.34% in 2010. The final column (count) in this panel indicates that for 12 industries, Egypt's share of world trade increased. The right-handle panel of the table repeats the exercise but this time based on each country's top 20 exports in 2010.

From the left-handle panel, we can see that countries such as Brazil, China, India, South Korea, the Czech Republic and Hungary all increased their share of world trade in their most significant 2005 products. For each of these countries, the export share increased for at least 50% of the industries (see the "count" column). For some of the MENA countries (Lebanon, Morocco, Syria and Tunisia), the increase in their share of world exports is also true, but clearly focused on a smaller range of industries. For the remaining MENA countries, however, their share of world exports has declined, and this is also true of the EU and of the US. We also see that on average for the top 20 MENA exports, the MENA share of world exports in those products declined by nearly 13%, and the share of trade increased in eight industries.

As in the preceding table, an alternative is to consider the key 2010 exports to see if these might represent areas in which market share has been rising. For five of the MENA countries (Egypt, Israel, Jordan, Tunisia and Turkey), the share of trade has declined, while for four of them (Lebanon, Morocco, the Palestinian Authority and Syria) the share increased. In each case, the number of industries for which the world share of trade increased has gone up in comparison to the 2005 industries. For the MENA region as a whole, the share of world exports in their most significant export products declined by nearly 5%. In contrast, for South Korea, Brazil, China and India the increase in the share of world trade ranges from 9.48% to 43.45%; and for the Czech Republic, Hungary and Poland from 9.79% to 26.65%.

All of this serves to underline the point made by Augier et al., Chauffour and Hoekman, and Freund and Portugal-Perez regarding the comparative lack of export success in the MENA region, and the weak effects from preferential trading agreement. Augier et al.

argue that the countries of the southern Mediterranean have a locational advantage, which is their proximity to a very large market – that of the EU. Distance matters for trading purposes and the locational advantage is one that can be exploited by these countries. Given the empirical dominance of a small number of large firms in many countries exports, they argue that the resource-poor Mediterranean countries should focus on developing "export-oriented clusters".

A key part of the argument, however, is that the ability to take advantage of their proximity to a large high-income market via such export-oriented clusters requires an appropriate domestic environment, one in which non-tariff barriers to trade are minimised. The bulk of the chapter then goes on to highlight the prevalence of such non-tariff measures in a sample of five MENA countries.[3] NTMs serve to raise direct compliance costs and administrative costs, as well as impacting on market structure and competition through the segmentation of markets. One of the striking empirical results from the chapter is that NTMs appear to cover about 40% of the products imported by the five MENA countries, and 50% of the value of trade. Perhaps on the positive side, in comparison to other countries these figures are by no means outliers, and there is also evidence that there has been a significant decline in NTMs over the period. On the other hand, estimates of the price-wedges implied by these barriers for Tunisia and Morocco suggest that these are high. If one takes the basket of goods from the World Bank's International Price Comparison project, the average wedges are 62.6% for Morocco and 13.45% for Tunisia, with maximum wedges of up to 373% and 105.2%, respectively.

In response to this, Augier et al. make a range of specific policy suggestions with the aim of "fostering competition at home and competitiveness abroad". These include: harmonising with EU standards; the provision of better information on the presence of non-tariff measures; improved dialogue between the public and private sector on the obstacles to trade, investment and growth; the need for regulatory oversight bodies with the inclusion of competition policy functions; and the desirability of identifying

3 Egypt, Lebanon, Morocco, Tunisia and Syria.

the ‘low hanging fruit’ – those regulatory/policy areas where effective progress could be quickly and achieved and which are likely to impact positively on the development of exports and/or export clusters. They also argue that reducing NTMs and allowing for effective open and inclusive governance mechanisms helps promote the participation of the private sector and civil society in social and economic activity, and thus helps to underpin (and presumably sustain) what they call “deep democracy”.

Chauffour and Hoekman also argue that it is important for the MENA region to increase its integration, both regionally and globally. However, they suggest that it is hard to realise those benefits without opening up the domestic economy to trade in both goods and services, and without reducing the dominant role of the state and the attendant regulatory impediments arising from that involvement. This is particularly so given the growth of global value chains and international production-sharing arrangements. Hence, while there is some evidence of increased involvement by some MENA countries such as Tunisia in such arrangements, the authors argue that overall the participation of the MENA region in supply chains is very limited.

Several areas of policy reform are then identified. First, while (in some cases) domestic endowments such as oil are part of the explanation for low participation in supply chains, this is driven in large part by the prevalence of domestic regulatory barriers and red tape. These barriers restrict the degree of “connectivity” between firms. Chauffour and Hoekman show that the overall Trade Restrictiveness Index for countries such as Egypt, Tunisia and Jordan is at 33%, 29% and 24%, respectively, whereas by comparison in South Asia, Latin America and the Caribbean, and Europe and Central Asia it is 14%, 14% and 11%, respectively, and in high-income countries it stands at 3%. Reducing such barriers should therefore be a priority. The key barriers are not primarily those related to tariffs, but more those related to trade facilitation (including trade logistics) and transport-related infrastructure. The infrastructure constraints are both national but also intra-regional, and the authors suggest that policies should be implemented in order to improve sub-regional trade corridors and regional trade facilitation. They also argue that attention needs to be focused on the market for services not only because this provides greater scope for growth via diversification, but also because of the important role of services in supply chains. In turn, this requires the removal of barriers to investment which can be significant.

Overall, they argue that the reform process needs to focus on facilitating greater investment, both domestic and foreign, and on reducing in barriers to connectivity between firms and between countries. Making markets more flexible and contestable will encourage the growth of the private sector which, in turn, can lead to substantial payoffs in terms of economic growth and employment. By implication, in the absence of such reforms the region will struggle to maintain, let alone increase, competitiveness, and will struggle to achieve sufficiently high rates of economic growth to deal with the rapidly expanding populations. They also recognise and underline the importance of the political dimension in enabling all of the above. Changes in policy inevitably involve some redistribution between groups and sectors in society. In particular, the policies suggested imply a shift away from the state and those with close connections to the state – and such changes are often harder to introduce as they require a sufficiently strong domestic caucus in their support.

In their respective ways, the contributions in this volume all point to the substantial challenges facing the MENA region. These challenges are both domestic and international, and clearly the nature of those challenges varies considerably across the countries studied, such that there is no simple blueprint answer. While Syria and Egypt may share the need to transform their economies from highly interventionist environments with considerable state intervention and significant elements of corruption and bureaucratic opacity, they also differ considerably in their historical circumstances and therefore in the sequencing of reforms, the nature of the institutions and regulatory overhaul that is needed. In contrast, Morocco has already moved further both with regards to democratisation and also with respect to developing a market economy with reformed institutions and regulations. As emphasised by all of the authors in different ways, successful reforms require the political will and a social contract/social safety net which while not simply enabling the reform to occur, do encourage the participation of civil society and business in that process of transformation. Without the conjunction of the two, successful reform is simply unlikely.

All of the authors stress the importance of integration into both regional and world markets, with some seeing the former as a stepping stone towards the latter. This is perceived as important to exploit comparative advantage, to provide a competitive impulse to the economies, to allow for economies of scale and, as several of the contributions underline, to facilitate the integration of the MENA economies into both regional and global supply chains. This is not simply a question of reducing tariffs and border barriers, or what is traditionally referred to as shallow integration. The strong message which emerges is that this requires more fundamental domestic regulatory and institutional reform, and deeper integration with the region, with the EU and with the wider world.

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2 Prospects for Egypt's integration in the world economy after the 25th of January revolution: A political economy perspective

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Introduction

Egypt is at a crossroads, not only from a political point of view but also on economic and social grounds. The 25th of January revolution and its aftermath have shocked Egyptian society. Day-to-day incidents have shown huge divergence and clear segmentation among the Egyptians, an issue that was neither revealed to such an extent before the revolution nor was expected to be so extreme after the revolution. The transitional period is proving anything but being easy to manage on all fronts. The Supreme Council for Armed Forces (SCAF) showed that it was unable to run the country, even for the transitional period, with worsening security, accusations of foreign "hands" aimed at destroying the country, and instability in foreign relations. The economic situation has been deteriorating at high speed, and conspiracy theory among all different powers has been the norm. Yet, in this state of flux that Egypt and Egyptians are experiencing, there is an expectation of the emergence of a "new" Egypt on all fronts. While the political scene has been dynamic and societal segmentation has emerged (with the rising of political Islam with its different threads, and different secular moves), the features of the new economic system have been vague. Economics, so far, has taken a back seat. This situation cannot be sustained, however. The deterioration of all economic variables has not yet been *extensively* felt by the society, but soon the implications of the hazy and bad management of the economy will be drastically evident.

This chapter aims for an understanding of what type of economic system is likely to prevail in the future, with special emphasis on its impact on Egypt's integration in the world economy. In doing so, it starts by assessing the economic policies in Mubarak's era, with an emphasis on the last 20 years, while trying to figure out what went wrong and comparing the current situation with the situation that prevailed with the 1953 revolution. It also provides some lessons to be learned from Central and Eastern European Countries (CEECs). It then moves to analysing the current situation and how political powers and parties have perceived the economic policies and issues. The paper ends up by drafting the main features for a vision of the future economic system while emphasising the importance of integration in the world economy, with certain preconditions, to enhance the competitiveness of Egyptian products in foreign markets while benefiting from foreign investments and products imported in the domestic market.

1 A review of the past era on the relationship between economy and politics: Who influences whom?

In the beginning of Mubarak's rule in the early 1980s, the economic situation was extremely poor – large budget deficits, high external debt (with total debt service ratio to exports of goods, services and income reaching 36.5% in 1989[1]), and significant balance of payments deficits. Yet Mubarak identified that it was the mistakes of his predecessor which had created this economic situation. The integration of the Egyptian economy in the world was relatively weak (with no engagement in any preferential trade agreements (PTAs) and modest integration on the multilateral level) and market forces were heavily constrained (with a public sector contributing more than 50% of GDP and more than 40% of total employment)[2]. The case of Egypt was perhaps not atypical, as integration in the world economy was not then high on the agenda of both

1 For reference as a benchmark, this percentage was 6% in 2010. See World Bank (2011) World Development Indicators online version.
2 http://www.mop.gov.eg

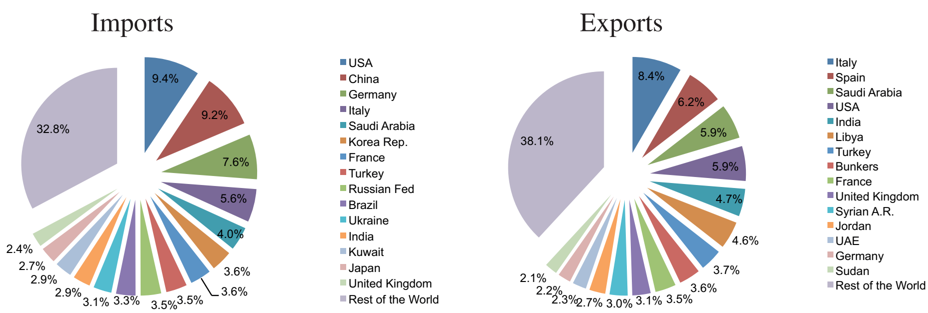
international organisations and developing countries. The economic situation continued to worsen in the 1980s and the Egyptian government failed to improve conditions. As a result, the government asked for the support of the World Bank and the IMF. In 1991, Egypt started to implement a classic structural reform programme following a classic "Washington Consensus" menu of prescriptions. It was at that time that politics and economics started to influence each other in a significant and evident manner.

Starting from the mid 1990s and with the conclusion of the Uruguay Round, integration in the world economy came to the forefront of the economic agenda of the majority of developing countries. The period coincided with the beginning of the proliferation of preferential trade agreements (PTAs) and the emphasis on the need for *deep integration* (where behind-the-borders matters play an important role in enhancing trade). At the worldwide level, an export development strategy accompanied by a free market economy became the bible for countries as a development strategy. The shift of Southeast Asian tigers towards aggressive export-oriented policies and the successive fall of planned economies of the CEECs have affected all developing countries, including Egypt. Over a period with conventional business cycles and a number of negative exogenous shocks, the Egyptian regime continued with its path towards a free market and integration in the world economy. Measures were undertaken on unilateral, regional, and multilateral levels to enhance the process of this integration. As a result, trade was heavily liberalised as successive waves of tariff reductions took place bringing down the average applied tariff rate from 38% in 1991 to less than 6% in 2010 (Ghoneim 2011). Moreover, starting in the mid 1990s, Egypt concluded at least eight PTAs with its major trading partners (EU Association Agreement, PAFTA, COMESA, Agadir, EFTA, Turkey, MERCOSUR, and QIZ[3]). Figure 1 shows the major trading partners of Egypt, where there is a high geographical concentration with the EU, US, and some Arab countries.

3 The EU Association Agreement is between the EU and Egypt, PAFTA is the Pan Arab Free Trade Area between 18 Arab countries, COMESA is the Common Market for East and South Africa between 18 African countries, Agadir is a free trade area between Egypt, Jordan, Tunisia, and Morocco, EFTA Agreement is between Egypt and EFTA countries, QIZ is Qualifying Industrial Zones, a special type of agreement allowing free access of Egyptian exports to US market provided they satisfy specific rules of origin including an Israeli component, and MERCOSUR is a free trade area between Egypt and the MERCOSUR countries including Brazil, Argentina, Uruguay, and Paraguay.

Yet, with such a shifting of gears to free market policies and integration in the world economy, the role of institutions that govern the market was left aside and the social safety net remained ill functioning. For example, privatisation was undertaken without clear and transparent rules, and without the presence of a competition law (which was only enacted in 2005). Moreover, and despite the fact that the figures published on poverty and human development might have shown positive or at least stagnant trends, the feeling among society was different, and was a negative perception. As argued by Maloney (2011, p. 68), “it is the global progress, and the growing gap in expectations of a better life and more modest reality, rather than mere poverty that sparks revolutionary mobilisation”.

Figure 1 Egypt’s major trading partners, 2010



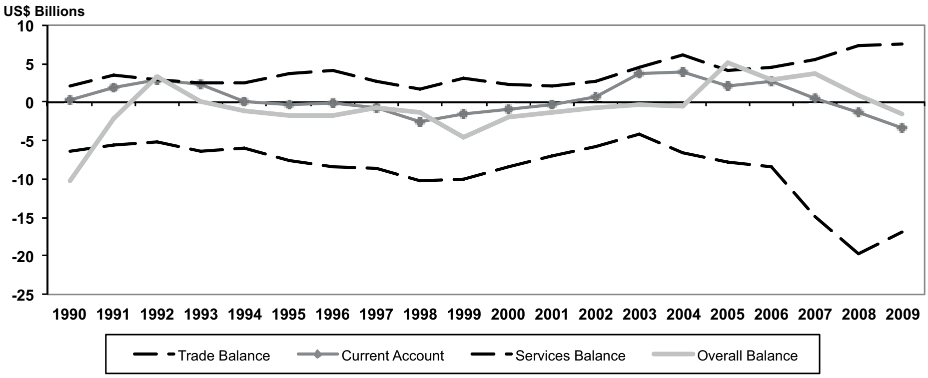
Source: Author’s Calculations based on UN ComTrade Database, available at http://wits.worldbank.org/wits/

Starting in the mid 1990s, the son of Mubarak started to appear on the scene and, slowly but surely, it became obvious he would succeed his father. This was a time when politics and economics highly influenced each other. Nepotism, favoritism and crony capitalism became evident features of the type of economic system prevailing in the mid 2000s. Creating a specific network of elites who owned the power and money through being members of the ruling National Democratic Party (NDP) and its policy committee, headed by Mubarak’s son, became key. In turn, the elite who benefited financially from their positions while at the same time being close to the regime would reciprocate by contributing to the NDP and presenting a positive image of the “coming” president. It could be said that the spread of grand corruption saw bribes paid by the regime to gain the loyalty of the elite, whereas petty corruption (which proliferated heavily) was the bribe paid to the poor to survive the worsening socioeconomic conditions and the inefficient social safety net. In doing so, the institutions had to be weakened and a blind eye was turned to laws and regulations. The end result was proliferation of corruption on all levels, with petty corruption acting as a social safety net and grand corruption used as a financing mechanism for the succession process of the son to his father.

Integration into the world economy was not affected by such shifts of political stances and the prevailing crony capitalism, and remained highly modest. Figures 2 and 3 show that the merchandise trade balance suffered from a chronic deficit, and trade openness (merchandise trade/GDP) remained in the range of 40%. Services trade played a role in increasing the trade openness ratio as well as making up for the chronic merchandise trade deficit. The benefits of integration in the world economy were not felt by the average citizen. The traditional welfare gains from opening up in terms of relative lower domestic prices did not materialise. On the contrary, prices of imports continued to increase despite the lowering of tariffs and engagement in many PTAs while maintaining an almost fixed exchange rate after major devaluations between 2001 and 2003 (despite the announcement of its flotation in 2003).

Based on back of envelope calculations, real GDP per capita grew by only 2% on an annual basis over the period 2001-10. The growth rate of non-oil exports increased, but imports grew faster and the chronic trade deficit continued to widen. The windfall gains of tourism receipts, Suez Canal fees, remittances and, to a lesser extent, aid and oil export revenues were the pillars that enabled the regime to maintain either a surplus in the balance of payments or a reasonable deficit (Figure 2). In fact, as reported by Ikram (2006, p.117) during the period 1965-2000 the current account of the balance of payments had been in constant deficit and it was foreign assistance, added to tourism receipts and Suez Canal revenues, that helped to reduce the deficit. Integration in the world economy continued to be an objective and not a means for improved economic welfare. In other words, in relative terms, integration in the world economy did not result in a relative improvement for the living conditions of the average Egyptian citizen.

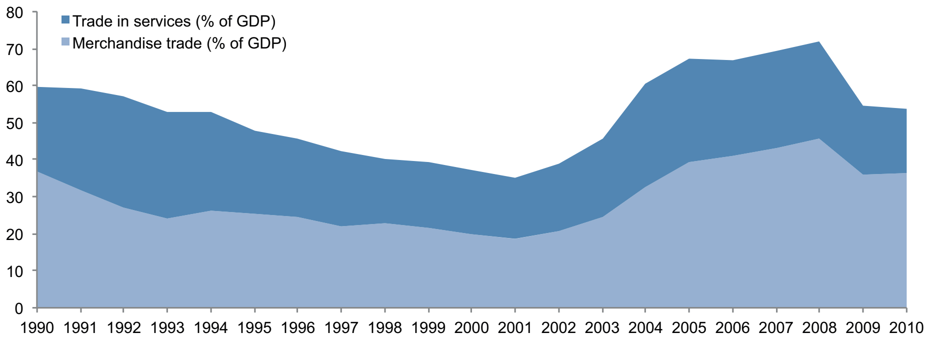
Figure 2 Balance of trade, balance of services, current account and overall balance (US$ billlion)



Source: IMF, IFS database, online version.

The failure of the old regime(s) was not because it opted for a free market system (in fact it did not) and integration in the world economy, but because it failed to implement a proper free market system and prepare appropriately to benefit from integration. As shown by Ikram (2006), the size of the public sector relative to GDP remained extremely high despite the announcement of the adoption of liberal policies starting in the 1970s. The size of public sector relative to GDP reached 50% in the 1980s and continued at this level in the 1990s. A market system implies, by default, a larger role for government on two fronts: through the social safety net, and proper, well-enforced regulations that govern the market (strong institutions). In both cases, there was a clear government failure in creating an efficient social safety net as well establishing a transparent, well-enforced regulatory system that governed the market. The nature of state business relationships has been based on a personalised rather than an institutional setup, where patronage and nepotism dominated (Malik and Awadallah, 2011). The end result was corruption, widening gaps between income levels, and a lack of justice. But this is due to the adoption of a free market system and integration in the world economy, rather it is because the government failed to set the needed pre-conditions for a market economy and integration in the world economy to function properly. A vibrant private sector failed to evolve and the regime failed to make integration in the world economy a public good aimed at increased prosperity. Integration in the world economy should have been used as a means to achieve increased prosperity which has not also been the case, with meagre growth rates of non-oil exports and modest levels of integration (it was only services trade, tourism and Suez Canal revenues that increased the extent of integration in the world economy), as shown in Figure 3.

Figure 3 Egypt's trade structure as a percent of GDP (1990-2010)



Source: World Bank, WDI Database, available online at: http://www.worldbank.org.

1.1 Is history repeating itself?

"One finds few indications of any political program or plan of action". "There were perhaps as many shades of political belief as there were members of the Free Officers Executive". "They (The Free Officers) had no action program that would have provided some conception of the society their revolution aimed at creating". Moreover, and most importantly "nor was the new regime wedded to a particular economic philosophy". Those quotes are from prominent historians cited in Ikram (2006). They accurately reflect the current situation although they were written to describe the circumstances of the 1952 revolution.

It is worth pointing out that the regime that governed in the aftermath of the 1952 revolution was in favour of private enterprise, a situation that continued until 1957. Even the agrarian reform was not intended to impede private property, it was rather intended to break up the power of the old ruling oligarchy. The major drastic move towards a socialist system where the public sector played a major role and started to dominate the economy took place in 1957 with the nationalisation of British and French economic interests after the Suez Canal War. The limited and declining access to western sources of finance and aid implied an inevitable shift to the Soviet and Eastern bloc. The move towards a planned economy intensified and was not changed until 1974 with the announcement of Sadat's open door policy. The open door policy did not represent a drastic shift towards integration, as the public sector continued to dominate the economic scene, and the shift to openness was only reflected on the consumption side of final goods. As argued in Ikram (2006), the open door policy represented some sort of immediate peace dividend between Sadat's governing regime and the general population who suffered years of a closed regime. It was also the only time where growth of the Egyptian economy was achieved due to an increase in total factor productivity (TFP) and not due to factor accumulation (mainly capital). In other words, integration in the world economy helped Egypt to achieve growth on a sustainable basis (Ikram, 2006 p. 107). After that, steps undertaken to enhance integration in the world economy intensified and became more formal with the engagement in the multilateral trading system (Egypt has been a member of the GATT since 1970) and the joining of several PTAs.

1.2 What can Egypt learn from the CEECs?

One major difference between Egypt and the CEECs that needs to be highlighted at the outset is the fact that Egypt, as well as those Arab countries that have experienced or are experiencing a revolution, are living a different phenomenon from that experienced by CEECs. Egypt is living economic hardships arising from the fall of dictatorships, whereas the CEECs experienced the birth of a new economic system. Hence, Egypt is endowed with institutions that might not have been functioning well due to nepotism and corruption whereas the CEECs did not have such institutions. Issues as privatisation, the price mechanism, free markets, and even to an extent private media have been present in Egypt but they were completely new to the CEECs. In other words, the CEECs witnessed a fully fledged transition in their economic systems, which is not the case of Egypt. Yet, there are still several lessons that can be learned.

First, there is a need to balance social and economic aspects during transition periods. If one overrides the other, the probability of sustaining growth becomes low. This has been evident in the case of Serbia where appreciation of the currency was adopted (which could be to achieve social goals such as lower inflation). The appreciation resulted in de-industrialisation of the economy and, hence, a loss of competitiveness in its manufacturing sector and a failure to create jobs. *The second main lesson that Egypt can learn from Serbia is the urgent and indispensable need for effective institutions and governance mechanisms that should accompany the transition to a market economy.* This is an issue that Serbia's government has paid due attention to, mainly in the banking sector to enable the private sector to have access to credit and reduce the lending bias toward state-owned enterprises. However, as pointed out by some observers and despite the announcement of Serbia's government of its intention to build up the right institutions, such efforts remained modest in terms of other economic governance issues such as competition policy and anti-corruption mechanisms (Simmons, 2010).

The case of Poland teaches us another lesson, which is that a choice has to be made between fast reforms, usually undertaken in a single package and known as the shock therapy/cold turkey (big bang) approach, and gradualism in reforms. Though Poland's case is different as the cold turkey reforms undertaken were mainly in the economic field, which is not the case of Egypt, the approach to reform is still important to highlight. Muczyk (1998) and Kolodko and Rutkowski (1991) classified the period of transition of Poland into three main phases, namely the "Handel" or stabilization period, the takeoff or transformation period, and the competitive parity or restructuring of the real sphere period. *It is important from a planning point of view to identify in which phase a country is so that society in general and policymakers specifically identify the goals of each period. Failure to identify such phases is likely to result in vague goals and a failure in attempts to achieve them.* Each phase has its own associated costs. In the case of Egypt, serving social and political goals implies significant economic costs associated with the increase in government budget allocations needed for social benefits, pressure on foreign reserves, etc. To lessen such costs, there is a need for effective coordination of economic policies and lowering of expectations of how the economy will respond due to the huge uncertainty prevailing. Poland's experience teaches us another extremely important lesson. *In the case of Egypt, given the social unrest, it is unlikely that any cold turkey approach can be applied to achieve economic goals, yet the fear is trying to respond to all social needs (unemployment, low real wages, etc.) in a cold turkey manner.* The economic costs associated with such an approach can be huge and can lead to social unrest again. Moreover, high expectations of how the economy can respond should be lowered, which is our final main lesson. The same is true in the case of Egypt, where governments need to be cautious over promises on improving living conditions in a fast manner, as if such expectations go wrong the stabilisation process can lead to destabilisation. In the case of Poland, and this is also likely to be important for Egypt, integration in the world economy (via trade and financial flows) seems to be an important element of lessening the economic costs associated with the transitional periods.

In addition to the lessons learnt from Serbia and Poland during the transition process, Estonia and Ukraine teach us another important lesson, which is the importance of the role of institutions in the transition process. Lack of institutions that ensure rule of law, good governance, the protection of property rights, the introduction of necessary laws and regulations, and which fight corruption (Gillies et al. 2001, Goncharuk 2006, Tsintsiruk and Deese 2008) can lead the transition process astray. This is an extremely important lesson for Egypt, where the focus on the political aspects and major economic policies to serve social interests can lead to the neglect or delay of reforms dealing with economic institutions. In this regard and as the experience of the CEECs showed, reform and transition were not properly implemented due to the lack of such institutions. What has proved to be effective afterwards has been the potential membership of the EU, whereas there is nothing similar in the case of Egypt.

Finally, it is important to highlight that remittances have played an important role in alleviating the costs of transition in countries which have had a significant migrant population, such as Serbia and Ukraine (Tsintsiruk and Deese, 2008). This indicates to Egypt that it should make best use of remittances, especially in the period where other sources of foreign currency and transfers, such as as exports proceeds, tourism revenues and capital inflows, are slowing down. The focus of reforms of the banking sector in almost all of the CEECs does not have an equivalent in Egypt which already has a well-functioning banking system that adheres to international standards. However, it is worthwhile emphasising the importance of the financial sector in the transition process as an intermediary of the sources of finance, as credit squeeze is a vivid symptom that has accompanied the transition period so far in Egypt and is likely to continue during the stabilisation period.

2 The economic turmoil after the revolution

The revolution in itself *did not* negatively affect the economic conditions in Egypt in a significant manner. Disruption of production for one month or so is not likely to have significantly affected the economy. Moreover, there was no disruption to infrastructure, thanks to the peaceful nature of the revolution, which implied no huge associated costs of the revolution per se.

However, the aftermath of the revolution has clearly negatively affected the economy, as has been revealed by deteriorating economic indicators. For example, there was a slowdown of the economy where the growth rate went from 5.9% in 2009-10 down to 1.9% in 2010-11 (CBE, 2011), unemployment reached alarmingly high rates, and net FDI inflows went down from US$6.6 billion in 2009-10 to US$2.2 billion in 2010-11 with a negative growth rate of 67%. The 2010-11 deficit in balance of payments reached unprecedented heights of US$9.8 billion (4.1% of GDP) compared to a surplus of US$3.4 billion (1.5% of GDP) in 2009-10, whereas international reserves slipped down from US$36 billion in January 2011 (covering more than eight month of imports) to US$16 billion in January 2012 (covering less than four months of imports).

Tourism receipts declined significantly and prospects for the future are worrisome as several kidnapping cases have taken place and one tourist has been killed, as well as several disturbances in all major tourist sites. Egypt's credit rating with major rating agencies has been downgraded several times since the beginning of the revolution, causing additional problems with Egypt's ability to borrow from abroad and its credit worthiness. As a result, the interest rate on treasury bills increased by almost two percentage points, making it more burdensome for the government to borrow. The government's overall[4] budget deficit reached a high of 142 billion Egyptian pounds (US$23 billion), representing around 10% of GDP, not including foreign and domestic debt service which reached US$99 billion.

The economic outlook is gloomy, and even gloomier than the IMF forecast. The IMF expected a decline in foreign reserves of US$9 billion[5], whereas reserves actually declined by almost US$9 billion in only four months and not a year (Table 1).

4 Revenues less expenditures, plus net acquisition of financial assets.
5 http://www.imf.org/external/region/mcd/deauville/note091011.pdf.

Table 1 Egypt selected indicators 2010-11 to 2012-13

	2010-11	2011-12	2012-13
		Projections	
GDP growth rate (%)	1.2	1.8	4
Inflation (%)	11.8	11	10.5
Fiscal balance (% of GDP) excluding grants	-10.3	-9.4	-9
Current account (%of GDP) excluding grants	-2.3	-2.7	-2.5
Fiscal financing needs (billion US$) excluding grants*	82.2	90.3	112.4
Fiscal financing needs (billion US$) excluding grants**	9.6	10.1	2.2
Public debt (% of GDP)	76.2	76.6	75.5
External debt (% of GDP)	15.1	13.8	13.0
Reserves to short term debt (%)***	295.2	259.4	174.2

Notes: * Gross financing requirement. ** Current account deficit excluding official grants plus capital account deficit. *** Official reserves.

Source: IMF (2011), Middle East and North Africa: Economic Outlook and Key Challenges, Deauville Partnership Ministerial Meeting, September 10, 2011, Marseille, France, available at http://www.imf.org/external/region/mcd/deauville/note091011.pdf.

There are two main reasons for the deterioration of the economic variables: the management of the economy by the post-revolution governments and SCAF, and the element of uncertainty which has been increasing over time due to several disruptions that have negatively affected the security level. SCAF has mismanaged the economy on many fronts, including the refusal to borrow from the IMF in March 2011. At that time, the economic situation was relatively better than it is now (March 2012), and the IMF announced that no conditionalities would be imposed. SCAF refused, however, basing its refusal on a populist argument that Egypt should not borrow from abroad (despite the fact that Egypt does not suffer from a high percentage of foreign debt to GDP, but rather from an extremely high percentage of domestic debt to GDP).

SCAF and the government increasingly created tension with the international community as well, accusing several human rights NGOs (including US and German ones) of working without a license and receiving unreported money to be distributed among political powers, and there has been concern that parties could in fact cut ties with the international community. Moreover, there were several anti-American announcements made by the Minister of Planning and International Cooperation[6]. This surely serves to impact on the economic situation through reductions in aid, reduction of investments, and the possible closing up of borders in face of Egyptian exports. This would have significant negative implications on the Egyptian economy and its integration in the world economy. Several other negative signals related to integration in the world economy have been announced by several ministers in the four governments over the last year, including possible retreats on future and existing privatisation attempts and related court decisions to bring privatised firms back to the government (even for firms that were privatised 20 years ago and have been sold several times afterwards), controlling imports, stopping foreign labour from working in Egyptian firms, and so on.

The high degree of uncertainty is therefore evident in the whole political scene, which in turn affects the economic situation. The difficulties in anticipating the shape and type of the new governing regime, the future role of the military, and the extent of the dominance of political Islam and its associated political parties have all contributed to this high degree of uncertainty. In economic terms, such uncertainty is translated into capital outflows, depleted foreign reserves, deterred investment, and high risk premiums and interest rates. Moreover, the frequent changing of governments and the lack of security are additional elements which add to the uncertainty. All of these symptoms imply *an economy in a stage of turbulence*. To a large extent, the uncertainty element can be overcome once the transitional period is over. Meanwhile, the management of the economy needs to be prudent and careful to ensure a stage of stabilisation until this period is over.

3 The road ahead: A vision for the future

The revolution of 25th January was embedded explicitly and implicitly in economic factors. The failure of the old regime to provide a decent life for the majority of the population and their support of the corrupt elite led to extremely high levels of

6 *El Youm el Sabaa* newspaper see http://www3.youm7.com/News.asp?NewsID=601584&SecID=65&IssueID=168

dissatisfaction among the population, especially the youth. The youth went out asking for "bread", "freedom", and "social equity". Those three important aspects of a decent life were not provided by the old regime. Hence, it is expected that any political power or party, regardless of its economic ideology or religious roots, will need to highlight such aspects in its election programme in order to fulfill the demands of the revolution. Such aspects are translated on the ground into the creation of jobs, fighting corruption, overcoming unemployment, and ensuring social equity. However, integration in the world economy does not feature as a critical element in this context. In fact, integration in the world economy can be viewed as a complementary device to achieve such goals. Its ability to achieve them depends heavily on the way it is managed and the domestic reforms undertaken to supplement the integration process. For example, as argued by Chauoffur (2011), the Arab Spring should be used as a means to enhance Arab integration and complete the Pan Arab Free Trade Area (PAFTA) by eliminating the non-tariff barriers and concluding the related regional services agreement. Malik and Awadallah (2012) argue that Arab integration could have been a regional public good bringing a prosperous future for Arab countries especially when markets are thin, which is the case for all Arab countries. However, the inability to create a vibrant private sector and a sound regulatory and institutional infrastructure means that benefits from such integration remain meagre.

On the ground, there is still a need to create a vision of what the economic system should look like. What are its main features given the wide variety of political, ideological and religious groups? Such a crucial aspect of Egypt's future has been largely neglected by the political powers, yet it is expected to gain attention in the remaining phase of the transitional period and afterwards.

Keeping aside the ideological political debates between different parties, what alternative do we have from an economic point of view? The answer is a modified free market system, which builds on the past but addresses the problems associated with market failure, ad hoc liberal decisions, and deeply rooted corruption. Advocates of a new system (and they are many) argue that the free market system of the old regime is the culprit for all Egyptian ills and call for more government involvement. But they never identified what is meant by that, bearing in mind that free market advocates also argue for more government involvement. Sometimes they refer to more involvement of the government in the production of goods and services (to balance the monopolistic and oligopolistic abuse of power by private players), and sometimes they call for better regulation. The scene is not clear, and it seems that all are aiming for the same thing but calling it something different. It was only recently that the government announced that the sin of the old regime was to adhere to the "Washington Consensus" and that they will follow the Japanese model (whatever that means!)[7] without taking into consideration the limits on the adoption of several protectionist policies due to international commitments. This is also in evidence when reviewing the election programmes of several political parties, including the ones dominating parliament. A comparison of the election programmes of a number of parties reveals the following:

1. The parties share almost the same views, which are liberal (either explicitly or implicitly) by all measures, emphasising the role of the liberal economy, the free market and the private sector. Some of them have gone further and emphasised the importance of privatisation.
2. All the parties have emphasised the importance of social equity, without clear identification of what this means and/or emphasising the importance of equal access for the public to different public services and jobs.
3. The majority of parties have emphasised the importance of the adoption of minimum wages.
4. All of the parties have emphasised the need to reform the institutions that govern the market, including competition and consumer protection laws, and the importance of a transparent budget.

7 See the statement of the Minister of Planning and International Cooperation in front of the Parliament on 13 February, 2012, available at http://www3.youm7.com/News.asp?NewsID=601630&SecID=65&IssueID=168

5. The majority have emphasised the importance of the need to reform the subsidy system, and especially the energy subsidy.
6. Some of them have emphasised the importance of research and development and the need to build society on a scientific basis.
7. The majority have emphasised the importance of establishing a social safety net.
8. The Islamic-based parties surprisingly share the same views as the liberal parties. The party with the highest number of votes (the political arm of the Moslem Brotherhood) calls for a free-market economy and a civil state led by the broad principles of Islamic law: freedom, justice and development. A push for tax and subsidy reforms is shared across the political spectrum. The exception lies in the ultra conservative stand of the Salafis' related party which explicitly mentioned the need to change the banking system's dependence on interest rates and the adoption of strict Islamic rules. The party said that such change should take place on a gradual basis, without identifying what this means.
9. The majority of the programmes emphasise the importance of job creation and poverty alleviation.
10. The difference in the point of views was revealed by some parties regarding the ascending tax structure, with some parties promoting it whereas others view that tax rates should be equal.
11. All parties have emphasised the importance of better utilisation of resources, particularly in the agriculture sector.
12. The majority of parties have emphasised the need to enhance the fight against corruption.
13. Most of the parties have emphasised the need to integrate in the world economy, yet without further details. In other words, it was more of a slogan than a vision.

Reality implies that integration in the world economy is the only way for Egypt to heal its economic ills in the short run (through capital inflows and aid) and it is an important, indispensible route in the long run (to overcome its limited domestic market) provided that certain preconditions are met. Integration should aim at improving the competitiveness of Egyptian exported products, and at benefiting from foreign investments and products imported in the domestic market to overcome low saving rates and enhance technological capabilities. The preconditions include overcoming the domestic obstacles related to infrastructure and regulatory framework that prevent the private sector from flourishing, while controlling corruption and ensuring social equity.

In other words, there does not seem to be a drastic shift away from a free market and integration in the world economy. On the contrary, there have been several incidents which demonstrate a continuation in the direction of integrating in the world economy. None of the political powers has mentioned any delink from integration in the world economy. The Moslem Brotherhood related party even made several signals that they do not intend to break up economic and trade relations with Israel. They identified that "Egypt will respect its international agreements", hinting towards the Qualifying Industrial Zones (QIZ) agreement with Israel[8]. The Moslem Brotherhood has been described by scholars as pragmatic (Hamid, 2011a, p. 33), which implies that it is unlikely that any drastic shift in economic policy will take place.

Even in the midst of the NGO problem, the deputy leader of the Moslem Brotherhood announced that the West should play a role in helping to finance Egypt's economic problems, signaling that relations with and dependence on the West will continue[9]. The reaction of several political groups to the American threat to stop economic aid in light of the NGOs problem created a sense of nationalism among different Egyptian political powers arguing that there is no need for it. However, this does not imply a delink from the world economy, it was more a matter of preserving national dignity. As stated by Hamid (2011b, p. 108), "Whatever the preferences of Islamist parties, Egypt will still be bound by old constraints. The country remains vulnerable during what will likely be

8 *El Youm el Sabaa* newspaper (dated 21 January, 2012), available at http://www3.youm7.com/News.asp?NewsID=582991
9 See Khairat El Shater statement at http://www3.youm7.com/News.asp?NewsID=594342

a long, difficult phase of transition. It can afford to irritate its Western allies but not to antagonize them".

What the political powers and parties have been missing, regardless of what economic system is adopted, is the need for strong regulations that *are well enforced*. The bizarre system that used to prevail before the revolution, and has intensified after the revolution, implies that the governing regime did not understand the lesson from an economic point of view, which is perfectly simple, that "people respond to incentives", whatever system you are adopting. What we need to create are the right incentives to ensure equality between private and social returns, to enhance productivity, and to shield the economy from corruption. Talking about raising wages without linking it to productivity is a myth, talking about stopping privatisation without setting a system for enhancing the public and private sectors is another myth, and saying that the free market system is the culprit and that more government involvement is needed is the *largest* myth.

3.1 Prospects for integration in the world economy

Regarding integration in the world economy, and based on what has already been mentioned, there are some important aspects that need to be emphasised:

1. The lack of vision of the transitional military on political and economic matters might not be a matter of bad intent, but rather a state of ignorance or bad management of a chaotic situation.
2. A careful read of the recent economic history of Egypt would show that integration and disintegration is not a matter of choice and action, they are rather a reaction, and that the trend (path dependence) has been the move towards integration.
3. This implies that to a large extent, Egyptian economic integration in the world economy in the coming period – especially in light of globalisation, membership of WTO, and PTAs – is very much likely to be shaped by domestic politics and interaction with the outside world. Tension in relations with the West (mainly the US) is not likely to result in a shift of the orientation towards new allies or a

domestic orientation due to the difficulties surrounding such options on political and economic fronts.

4. It is not only Egypt that is in a transitional stage; the West (and mainly the US) is also in a transitional stage, figuring out how to deal with the new context of the Middle East brought by the Arab Spring. The preface of a recently released book by the Brookings Institute stated that "we found that our views on how American interests were engaged by the developments in the Arab world and what policies the United States should pursue toward the Arab Spring were remarkably in sync." (p. xiii). This is also confirmed for the EU where Palacio (2012) emphasises that the Arab Spring should be a chance for the EU to change its relationship with the Arab countries from a patron/client relationship to a real partnership aimed at enhancing developmental aspects (and not mainly focusing on security measures) for the countries involved with EU in Association Agreements.

4. Where does Egypt stand?

There are several aspects that need to be taken into consideration when positioning Egypt from an economic point of view in the near future:

1. The socialist elements rooted in the economic system are likely to remain for a while. Any regime that governs will be extra cautious when embarking on any type of major market-oriented leapfrog. Moreover, the sensitivity of the transitional period and the period of social unrest that will follow will require continuing with high levels of public spending that is not sustainable from an economic point of view. Hence, a piecemeal market-oriented reform to avoid social and political unrest is expected. This does not imply that there is a tendency to invoke socialist ideas, rather that it is a consequence of the fear of social and/or political unrest if major reforms are undertaken. Perhaps economic relations with the outside world are the least likely economic aspects to be affected. The worsening domestic economic situation, mixed with the desire of the Moslem Brotherhood to keep good relations

with foreign powers, and certainly the need for foreign help, ensures that decisions that can disrupt relations with the outside world are not likely to be taken. In this regard, the Deauville Partnership was an initiative by the G8 to help Egypt, Tunisia and Libya in their process of transformation after the fall of their dictatorships. 30 billion euros were earmarked from different donors (bilateral, multilateral, and regional and international development banks) to help the countries transform to free and democratic regimes. There are five main areas of focus: 1) governance, transparency and accountability of economic activities; 2) social and economic inclusion; 3) economic modernisation and job creation; 4) private sector led economic growth; and 5) regional and global integration.

2. A positive aspect stemming from the tension between the regime in Egypt and the West over the foreign NGOs is that having come early in the process, it could act as a new start for the coming regime where both the regimes governing Egypt and the West (mainly the US) can always blame the former regime(s) for the incident.
3. It is unlikely that there will be a clear economic system that characterises Egypt's economic regime. It will continue to be presented as a free market economy willing to and working to integrate regionally and globally, while emphasising the social repercussions of such integration. This implies that some socialist elements will continue to characterise the Egyptian economy.
4. The Egyptian economy will continue to face three main challenges in the coming period: 1) creating employment opportunities, and especially for youth (taking into consideration that there are 800,000 new entrants to the labour market each year) requiring at least a rate of growth of 6.5-7% on an annual basis for at least two decades (Ikram, 2006 p. 283); 2) combating poverty and worsening income distribution; and 3) modernising the Egyptian economy so it can meet the challenge of integrating in the world economy.

There are several pragmatic steps that need to be taken to ensure challenges of the future are met, including better terms for integration in the world economy once the political scene is clear and the security situation is stable. Among the most important steps are the following:

1. There is an urgent need to promote FDI in the country. The low savings rate as a percentage of GDP and its inability to finance the investments needed to ensure a decent growth rate implies that Egypt is in need of increased FDI inflows. Yet the quality of the FDI needs to be more responsive to developmental needs, where greenfield (and not brownfield) investment is what is needed. The sectoral and geographical allocation of FDI might be in need of a new mechanism to ensure that FDI is directed to the sectors and geographical areas that can help Egypt to develop.
2. The governing institutional setup is need of drastic reform. A mechanism that ensures a committed, accountable, and capable government should be designed to ensure macroeconomic stability while paying due attention to social aspects of economic decisions. The institutional setup should also work on strengthening the regulatory regime that will help Egypt to integrate in the world economy on better terms. In this regard, there are several policies and related regulations that need reform including investment, competition, consumer protection, and government procurement policies to clean up the symptoms of corruption and crony capitalism that proliferated.
3. SMEs should be better integrated in the value chain of production and exporting. Given the importance of SMEs in the Egyptian economy, they should receive extra attention. SMEs are now the essence of the Egyptian economy as they represent about 99% of the non-agricultural private sector, three-quarters of the total labour force in the private sector, and 75% of the value added. Yet, SMEs have been facing several impediments which hinder them from contributing effectively to the Egyptian economy in general and to exports specifically (including informality, weak access to finance and market information, lack of export skills and knowledge, etc.). A new context in how to deal with SMEs is needed, particularly as they do not share the same characteristics as different industries. Moreover, the way of integrating them differs from one sector to another.

4. Making use of the revolution by branding Egyptian products. A new logo should be used by all Egyptian exports on a voluntary basis which should be accompanied by a worldwide campaign that promotes the new era of Egypt.
5. Rethinking trade finance. The role of the Export Development Bank of Egypt (EDBE) needs to be revisited as it has been acting as a traditional commercial bank. Specific export-related services should be considered. SMEs' export finance should be provided via the EDBE, yet with new criteria set for its performance, not only based on the conventional measures of assessing banks but also on the expansion of its services to include SMEs and its focus on its main objective, which is to finance exports. The EDBE has various export finance tools but utilisation is low due to constraints on the user side, i.e. inadequate export business and lack of collateral. Instead it is left offering basic international trade credit and other services, with a focus on large enterprises. Moreover, the resources available for the Egyptian Credit Guarantee Company of Egypt (ECGC) are limited, and it cannot guarantee transactions in certain countries unless it has a government backup guarantee, whose procedures are difficult to apply.

Integration in the world economy should follow a holistic approach, and not be undertaken on an ad hoc basis. It should be used as a means and not an end. At its core, integration in the world economy is about improving the competitiveness of Egyptian products to successfully penetrate foreign markets, while benefiting from foreign investments and products imported in the domestic market. This implies that integration in the world economy should be looked at differently while paying due attention to additional variables such as backward and forward linkages in the different sectors, being part of the value chain of the world production, enhancing productivity, and most importantly reforming the process of doing business (Egypt's position in the latest *Doing Business* Report 2012 published by the World Bank and the IFC shows a deteriorated position – 110 out of 183 countries)[10]. In other words, integration should serve development. Integration will be more fruitful for Egypt through joining the value

10 http://www.doingbusiness.org/data/exploreeconomies/egypt

chain, where Egypt should locate itself as an important producer of certain components of products by focusing on specific niches and markets based on its different attributes of comparative advantage (cheap labour, geographical proximity to Europe, Arab countries, and Africa, etc.). With the problems that the EU and the US economies are facing, it is unlikely that Egyptian exports of final goods and services can flourish in markets. Hence, it is worth shifting the strategy of exporting towards being part of the value chain with Southeast Asian countries and BRIC, while building on its comparative advantage. Yet, the EU and the US should work on enhancing the domestic capacity to trade in Egypt (including infrastructure, human capacity, standards, etc.) and should also work on enhancing regional trade between Egypt and its neighbours, which is highly impeded by a proliferation of non-tariff barriers (Ghoneim, 2011) . It is equally, or more, difficult to penetrate the Southeast Asian markets which are more competitive by all measures when compared to Egypt. The only way out is to be part of the value chain.

A concluding note

To conclude, Egypt's integration in the world economy via trade is not likely to change in the short run. Even though the there are economic hardships experienced in its two main trading partners (the US and the EU) coupled by some political frictions, it is not expected that strategic relations are likely to be affected. In the case of the US, the rising political powers and the governing authorities in Egypt might be looking for new rules of the relationship, but by all accounts it is neither in the interest of the US nor Egypt to breakup the relationship. The shift of Egypt's orientation towards other parts of the world (e.g. Southeast Asia) will need time and any new setup through engagement in the value chain of products produced by those countries will take time to evolve.

Egypt's integration via capital flows, including aid, might be altered in the short run. With the exception of the Deauville Partnership, it is very likely that there will be a shift to aid and investment flows arising more from the Gulf, as the Gulf would like to support Islamic governments, and it is expected that the Western part of the world will be conservative, at least for the time being. From a political perspective, it is unlikely that sources of finance will dry up, but a more conservative approach will be adopted. As pointed out by Ajami (2012), foreign assistance is indispensible for Egypt which lacks the oil (unlike Iran) that could enable its regime to forego its foreign relations. On political and economic levels, it is in their interests of both the West and Egypt to continue financing Egypt's building and development, yet perhaps on a new basis that respects Egypt's dignity and avoids imposing conditions. Donors should shift their focus from enhancing stability (which they always did and failed) to helping to build a new, modern Egypt by enhancing development where democracy, good governance, and integration in the world economy are the main pillars.

Finally, if whichever regime that governs Egypt takes into consideration aspects of a full comprehensive plan on a systematic and pragmatic approach to integration in the world economy, while controlling for nepotism and corruption, then Egypt's status in terms of integration in the world economy will surely be enhanced. However, timing is an important element here. Given the domestic upheaval currently prevailing with elements of sensitivity of dealing with the West, and based on previous history, it seems that the route to integration in the world economy will continue, yet it requires prudent steps. The steps that are likely to be followed are a mixture of proactive measures such as agreements to be part of the global value chain and enhancing industrial (versus trade) cooperation with the outside world, and reactive measures by maintaining a low profile for (yet not dismantling) PTAs that have sensitive political aspects (e.g. aspects of human rights embedded in the EU Association Agreement or dealing with the QIZ).

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3 Syria's long road to self-healing[1]

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Greater Syria, located at the crossroads of three continents, has long been a battleground for the empires and dynasties that came to lay claim on its fertile fields and forests. Independence changed the locus of decisions, but even today Syria — the beating heart of Arab nationalism — continues to bleed. Much of what the Syrian people gained from throwing off foreign control was quickly lost to home-grown tyranny under the Assad regime.

In March 2011, and in the middle of what has come to be affectionately called the "Arab Spring," the people of Damascus declared a "Day of Dignity" and demanded the release of political prisoners. The reaction of the regime was swift and brutal — more people were arrested triggering a "Day of Rage" rally in the southern city of Deraa. There, security forces began their bloody campaign against an unarmed civilian population. More than 365 such days have since passed with a mounting death toll and arrests. The prisoners and the dead include children, women, and the elderly.

Syria has since been living a continuous "Srebrenica moment," leading to Arab and international outrage and condemnations of the barbaric actions perpetrated by

1 This chapter draws on a case study on Syria prepared under a research project on "Transition from Autocracy to Democracy in the Arab World," co-managed by Ibrahim El Badawi and Samir Makdisi and supported by an IDRC grant. The project is housed at the Institute of Financial Economics, American University of Beirut. The views expressed therein are the author's own.

the regime's forces. A UN resolution to bring these moments to an end continues to elude the international community. It is nonetheless hard to imagine the Assad regime holding its population hostage interminably, and flouting the will of nearly the entire international community. Already, the regime is living on borrowed time. This begs the question as to what comes next.

This chapter will focus on the economics that will need to accompany the political changes underway in Syria. The path defined below is governed as much as humanly possible by an attempt to heed the lessons of history, geography, and rational economic thinking. It also rests heavily on the premise that meaningful political and economic freedoms are inseparable. An economic awakening in Syria should go hand-in-hand with the political awakening now underway. It is not too soon to help a post-Assad Syria find the right path. As Syria joins the ranks of democratic societies and regains peace and stability, it needs to establish the foundations for a free market economy and enhance its integration in regional, and eventually global, markets for goods, services and ideas. Private-sector-led growth is the new economic model for Syria, and one that will respond to the aspirations of its people for freedom, dignity and prosperity.

Politics of the Assad regime

The Assad regime was erected on the many historical and geographical curses and blessings that have shaped modern day Syria. The late President Hafez Assad assumed power in 1971 following a bloodless intra-party coup, known as the Corrective Movement. His coup came on top of 21 other coups and counter coups that have become Syria's political leitmotif ever since it gained its independence from France in 1946.

Knowing full well how his predecessors had fared, Hafez Assad concentrated in the presidency, arrogating to himself all important decisions regarding foreign policy, national security, internal politics and the economy. The executive, legislative and judiciary branches of government came under the control of key figures in the Ba'ath

Party, whose dominance in state institutions was mandated by the constitution. Hafez Assad would rule Syria for close to three decades with an iron fist.

This autocratic regime survived Hafez Assad's death in 2000, and has continued under the regime of his son, Bashar Assad. In Assad father and son's Syria, ministers and senior staff members of the state are nominated by the president and assigned limited executive rights. The Regional Command of the Ba'ath party and other secondary circles of the power system propose candidates for government posts and key civil service positions, but the final selection is always made by the president. The government does not govern according to any specific programme, but rather takes decisions according to the interests of the power system. Any dissent risks political detention, torture and disappearances.

The regime also used the need for "security" as a pretext to silence dissent. The state of emergency that one of Hafez Assad's fleeting predecessors had imposed in 1963 remained in force until Bashar Assad rescinded it in April 2011, apparently as a gesture of "goodwill" to protestors. Freedom of association, expression and assembly were always strictly prohibited.

Assad and many of his aides belonged to the Alawite sect, so his assumption of power gave rise to hidden grievance on the part of the Sunni majority. They saw power resting exclusively in the hands of a minority sect with all the privileges that go with it. The fact that the ruling Ba'ath Party was secular did not alter these feelings. The authorities also treated Kurds, Syria's largest non-Arab minority, as second-class citizens subject to systematic discrimination. Bashar Assad's April 2011 offer of citizenship to the Kurds merely added a retrospective insult to a perennial injury.

Independent correspondents, including bloggers, face arrest and harassment, while the regime monopolises all forms of large-scale media and restricts access to the internet. Assad's machine also uses the pretext of national security to justify its stranglehold on the judicial system. Torture and ill-treatment of prisoners is carried out with total impunity.

The Assad regime did not completely consolidate its power until early 1982, when it violently suppressed a Muslim Brotherhood insurrection in the city of Hama. Thousands were killed and whole segments of the city were obliterated. This action followed a series of violent incidents and clashes between the Brotherhood and the regime dating back before Hafez Assad had assumed full power in 1970. The regime subsequently introduced several measures to strengthen its authoritarian hold. Director generals of various ministries (i.e., the senior civil servants who guarantee the continuity of public sector institutions) were replaced by assistants to the minister who could be changed at will. All public political discussions were henceforth monitored and activities by opposition groups banned, and all political parties were subjected to Ba'ath Party rules and prohibited from opening offices or publishing newspapers and newsletters.

When Hafez Assad died in June 2000, potential constitutional hurdles were overcome and by popular referendum Bashar Assad was elected to succeed his father exactly one month later. At the same time, he assumed the positions of General Commander of the Armed Forces, Secretary-General of the Party and leader of the Progressive National Front. Despite an outward appearance of youth and modernity, he followed his father in holding monopoly power over state and party.

Bashar stated in his inaugural speech that there can be no democracy without the development of institutions and without administrative reforms. The speech gave intellectuals and dissidents a whiff of hope and they began calling publicly for economic and political reforms (popularly referred to as the Damascus Spring). This freedom was short-lived, and the regime reversed course in early 2001. Now, almost 12 years into Bashar's presidency, the power system remains as closely knit as under Hafez.

Economics of the Assad regime

The economic landscape that the Assad regime created is a mirror image of its political reality: highly centralised and *dirigiste*. The two Assads have followed a state-led economic development model that is anchored in a strong interventionist-redistributive mentality that included heavy reliance on state planning, import substitution policies, nationalisation of private and foreign assets, and a social contract whereby the state provided education, housing, health care and food subsidies.

Over time, the party's monopoly of power has given rise to systemised corruption and kickbacks, with key decision-makers taking advantage of their position to extract illegal profits. Suffering from low salaries, the army as well as the judiciary system has fallen prey to corrupting influences. Unsurprisingly, and despite early, relatively high rates of economic growth and living standards, the national economy has been marred with significant inefficiencies and periods of stagnation, despite occasional cosmetic attempts at economic reforms.

Since Bashar Assad took over the presidency in 2001, the fundamental aspects of the Syrian economy have remained unchanged: strong dependence on volatile oil markets, limited private sector activity, limited employment creation, and declining integration into the world economy. This is perhaps not surprising in view of the influence of entrenched interests and the regime's power base that have combined to offer at best cosmetic touches of reform.

	2000	2005	2006	2007	2008	2009	2010
Exports of goods and services (% of GDP)	35.39	40.39	39.50	38.64	36.84	29.08	35.33
GDP growth (annual %)	2.74	6.20	5.00	5.70	4.50	6.00	3.20
Imports of goods and services (% of GDP)	28.58	41.62	38.72	37.83	36.72	31.15	35.76
Inflation, GDP deflator (annual %)	9.70	11.97	7.79	11.97	15.95	-2.80	6.26
Merchandise trade (% of GDP)	43.72	67.81	67.22	64.85	63.74	48.48	51.40
Population growth (annual %)	2.67	2.66	2.04	2.04	2.04	2.04	2.04
Services, etc., value added (% of GDP)	38.31	44.31	45.50	49.09	49.35	46.47	..

Syria's economy was relatively developed when it gained its independence in 1946. From then through the mid-1970s, it enjoyed unprecedented levels of economic growth; average annual GDP growth rates during that period were 6.3 % in constant

1963 prices. Rising oil prices, intra-regional flow of capital, and labour and workers' remittances helped to fund social development and public investments in infrastructure, health, and education, as well as state-owned enterprises operating behind high and opaque protective walls. By the end of the 1970s, the Syrian economy had shifted from its traditional agrarian base to an economy based on commercial, service, and industrial activities. The main sources of Syria's income were oil and tourism. Nevertheless, the economy continued to rely heavily on foreign aid and grants to finance both its budget and trade deficits; Arab aid transfers and Soviet assistance also supported mounting defense expenditures.

By the mid-1980s, Syria's interventionist-redistributive model ran out of steam as the economy's past prosperity all but disappeared, and was even negative (-2 % GDP growth rate in 1982-83) in the wake of a rapid decline in oil prices, lower export revenues, drought that affected agricultural production, and falling workers' remittances. This prompted the government to rethink its economic management approach and to adopt policies to achieve macroeconomic stability, a larger participation of the private sector in economic activity, and a higher degree of integration into global markets. The government reduced its spending, cut down on imports, and launched anti-corruption campaigns against black market currency dealers. The measures taken did not go far enough in addressing the deep-rooted structural problems of the economy, nor did they seriously tackle governance and institutional reform issues.

The government also began to reform its state-led economy, with initiatives such as liberalising the agriculture sector and privatising several state monopolies. This paved the way for Syria's considerable economic development and significant capital accumulation in the early 1990s. Growth rates accelerated in part due to oil revenues (and discoveries of new oil deposits) and to initial domestic liberalisation measures. By the end of the 1990s, however, the pace of economic liberalisation had slowed, favouring members of the powerful elite; during the period 1997-99, Syria's economy grew by an annual average of 1.5% per annum, and in 1999 the economy actually shrank. In 2000 and 2001, the Syrian economy recovered, owing to increases in oil exports and cooperation with Iraq, which was under UN-imposed economic sanctions at the time. At the same time, earlier reforms proposed by the regime of Hafez Assad stalled, and the country's infrastructure deteriorated.

The Syrian economy has been going through a roller coaster ride since the late 1990s. During the period 2000 to 2010, the annual rate of growth averaged close to 3% in tandem with the growth in the population and, as a result, standards of living have deteriorated, poverty has become more widespread, and unemployment levels have risen. Syria's public sector is bloated, employing roughly one quarter of the total work force in money-losing state-run companies that are kept afloat under the pretext that their privatisation would generate a great social disruption.

Liberalisation measures have been further hindered by the business community's allegiance to the regime. Involved with influential members of the regime in rent-seeking activities (oil, foreign trade, mobile phones, etc.), the Syrian business community has sided with and reinforced the autocratic regime, indicating little interest in fostering democratic development. Reforms have failed to develop without the business community's support. Foreign companies across all sectors have operated in Syria for decades through middlemen (sponsors) in the power system, weakening the strength of Western pressure to liberalise. Western oil companies, in particular, have invested heavily and have begun operations in cooperation with the Syrian authorities, the only way to gain access to the Syrian market. This issue is not unique to Syria but leads to the question as to whether market liberalisation and reform on their own could promote a business community interested in a genuine democracy, or simply give rise to crony capitalism.

As a direct result of the policies adopted from the 1960s through the late 1980s, the Syrian economy remains relatively isolated from the global markets for goods and services. International trade is highly restricted by both tariff and non-tariff barriers, and all the efforts at liberalisation have left in their wake a web of protection that distorts economic incentives and discourages competition. Syria's tariff regime is one of the world's most complex and opaque regimes, both in absolute terms and in comparison to other countries at similar levels of economic development.

While tariff rates have been reduced from their historically high levels, they are still very high compared to those of other developing countries, ranging from 6% to 235%. The tariff schedule is also marred by a complex web of exceptions and special rates that are determined according to the origin of the import and the entity that is importing it. Around 200 state-owned companies enjoy different levels of subsidy and protection; many also have either the exclusive right to import some goods, or have the exclusive right to grant licenses for key imports. Syria bans the import of certain final goods that compete with Syrian enterprises. There are also goods whose importation into Syria is prohibited. One may argue that quite legitimate public policy objectives (security, health, or protection of the environment) may lie behind these prohibitions, but in Syria the list is extensive and the criteria are not publicly known. Not only have these practices injected further distortions into the economy, but they have given rise to a culture of rent-seeking. Quantitative restrictions add up to the equivalent of a 19% across-the-board tariff on all imports.

Bashar Assad inherited an economy that had been facing grave economic challenges, including restoring economic growth, addressing rising population growth, alleviating poverty and providing jobs, attracting investment, and tackling a large external debt. The government initiated modest economic reforms, starting with a rethink of the regulatory environment in the financial sector, including cutting lending interest rates, licensing private banks, and consolidating multiple exchange rates. Other reforms saw a reduction in subsidies on some items, most notably gasoline and cement, and the establishment of the Damascus Stock Exchange, which began operations in 2009. In addition, President Assad signed legislative decrees to encourage corporate ownership reform, and to allow the central bank to issue treasury bills and bonds for government debt.

Partly as a result of these and other reforms, the economy made a remarkable turn and registered impressive performances from 2004 onwards, the rate of growth averaging five percent during 2004-10 (lower oil exports were offset by higher prices, leading to higher budgetary and export receipts). However, the main drivers of growth were domestic demand augmented by the influx of Iraqi refugees, and private investment, both domestic and foreign, particularly from the Gulf States.

Despite these reforms, competition in Syria remains limited and substantial barriers to entry continue to plague many economic sectors. Some productive sectors remain firmly in the hands of the government, while for others foreign entry remains subject to certain types of restrictions. Public sector monopolies control cement, sugar-refining, fertilizers, oil refining, port operation, water distribution, air transportation, electricity, telecommunications, and insurance. Inefficient state-owned enterprises and public authorities play key roles in many value chains through, for example, exclusive control of the procurement and sale of cotton and wheat, exclusive control of yarn-making, and through the provision of infrastructure. In summary, Syria's economy continues until today to suffer from deep-rooted structural weaknesses and a business environment plagued by bureaucratic red tape, governance weaknesses, and a lack of corporate transparency. Unsurprisingly, the World Bank's ease of doing business rankings for 2011 ranked Syria at 134 out of 183 countries.

Moving forward: Institutions for economic development and democratic build-up

The Syrian revolution marks the beginning of a new era. The democratic build-up is underway, on the streets of Syrian cities and villages and outside Syria through the Syrian National Council. As Syria moves to oust a dictator and claim its rightful place among democratic societies, its economy needs to move in the same direction and manner, establish and embrace free market ideals and gradually integrate into the global market for goods, services and ideas.

Lessons of experience from transition economies argue against any “shock therapy” and in favour of a gradual approach to reform. Syria needs to abandon in a gradual manner its state-led, dirigiste economic model in favour of a market-based one. The country needs to unleash the great entrepreneurial spirit that has characterised Syrian industrialists and merchants throughout history; open and fair competition should replace the system of privileges that has besieged the economy for more than four decades now. Flexible labour market policies will help develop workers’ skills and facilitate labour mobility across occupations, firms, industries and regions while providing adequate assistance to those who experience adjustment costs as a result of structural change. An open and transparent trade and investment regime will help dissipate the rents that have been amassed behind closed borders and opaque rules. The key objective here is to enhance productivity and competitiveness of the Syrian economy, and put it on a path where growth and employment generation are led by the private sector.

Experience shows that reforms should be pursued across different policy areas in a complementary way: To promote acceptance of change, by helping ensure that those disadvantaged by one reform benefit from another, and to foster synergies between policies. The key to successful transition lies less in individual policies themselves than in the way policies interact; the benefits of an open trade and investment regime, for example, will only be fully realised in an economy with appropriate macroeconomic policies, efficient labour markets and a regulatory environment that encourages the entry and exit of firms, and an education system that enables skills to match evolving needs. While this will mean pursuing policy reforms in parallel, the precise sequence may need to be flexible.

Even the closest managers of an economy cannot consider every detail whereas, as Adam Smith noted, a community of individuals each responding to self-interest informed by price signals can do so in a market. Governments cannot prevent individuals from making the best of their own particular circumstances, so the key to success is to harness this huge motive force to the right set of signals. This is what market forces do. Subject to the correction of obvious market failures such as missing markets, externalities and public goods, encouraging economic actors to respond flexibly to the incentives they perceive around them generates both strong responses to obvious signals and an informative variety of responses to less obvious ones. Provided that subsequent selection is efficient such natural experimentation is a much more reliable way to develop constructive responses to challenges than is bureaucratic centralism.

Once one moves beyond the bounds of almost complete autarky, every economy depends ultimately on the world economy as the arbiter of economic value; goods and services are worth no more and no less than the prices at which they can be obtained from or provided to the world market. Thus an economy that admits relatively undistorted signals about world scarcity and permits actors to respond to them is ultimately likely to do a very much better job of creating and preserving value and wealth than one which does not.

The power of an open economy also comes from the age-old principle of comparative advantage: countries, like individuals, prosper when they use their resources – natural, human, industrial, financial – to concentrate on what they do best. The essence of the case for liberal trade and investment is that incomes will be higher, nationally and internationally, if individuals and companies are free to engage in specialisation and exchange. Specialisation allows both businesses and individuals to deploy their relative strengths, abilities and expertise. Freedom of exchange, domestically, regionally and internationally lowers prices, broadens the range of quality goods and services available to firms and consumers, and allows investors to diversify risks, channel resources to where returns are highest and secure access to capital at the lowest possible cost.

In summary, the case for a private sector-led, open economic model relates to the natural preference of people the world over for more, rather than less, choice and freedom; the Syrians are no different. The power of the free market ideal lies to a great extent in the freedom individuals and societies gain from exercising greater choices over what to buy and to sell and at what price, where to obtain inputs, where and how to invest, what skills to acquire, or what regulatory approach to pursue.

While an open economy is an essential component of sustainable economic growth, complementary policies are also needed in order to realise the full benefits. In other words, the positive results from an open economy are not automatic, other policy choices matter as well.

Among the most fundamental is the establishment of an adequate system of economic governance that is built on strong institutions and protected by rule of law, which is crucial for property rights and for lowering transaction costs. I believe that supporting the establishment and the strengthening of domestic economic institutions in Syria is the starting point to achieving sustainable growth and political freedom. The questions are, what institutions and how to build them?

Early contributions on these issues came from Douglass North and Mancur Olsen among others, but in our current context the main protagonist has been Rodrik (2000) who addresses the question of what institutions matter and how to achieve them. On the former issue he identifies five critical areas:

- Property rights – strictly speaking, control over property rather than legal rights per se.
- Regulatory institutions to correct externalities, information failures and market power, such as anti-trust bodies, banking supervision and, more controversially, coordination of major investment decisions as Rodrik argues was provided by Korean and Taiwanese economic intervention.
- Institutions for macroeconomic stabilization, e.g., a lender of last resort.
- Social insurance – these are often transfer programmes, but Rodrik argues that other institutions such as jobs-for-life can also play the same role.
- Institutions to manage social conflict.

On the latter issue of how to acquire institutions, Rodrik makes two observations:

- There is no single optimal set of institutions, there are many ways of achieving the same objectives.

- Moreover, the interactions between institutions mean that the package needs to be considered as a whole (or at most in a few broad parts) rather than piece by piece.

Institutions can be adopted from abroad or evolved by trial and error locally. Rodrik prefers the latter, although he recognises that it often provides political cover for an unwillingness to reform, and that it takes time and can involve blind alleys. The critical issue here is the legitimacy of the institutions. Adopting foreign institutions can often be an efficient way of short-cutting the learning process and, indeed, good policymaking will always seek to learn from others' experience. The requirement, however, is that the institutions are sought as solutions to locally identified problems and are adapted to local needs and conditions in quite subtle ways. There is a world of difference between a society facing a problem and looking abroad for something to adapt to its own needs, and an external force declaring that a certain institution will be good for it.

At the external level, emphasis should be placed first and foremost on fostering economic freedom by providing direct support for social, human and economic development programmes that help the population. That also means opening markets to Syrian products, and promoting Syria's engagement in regional and eventually international markets for goods, services and ideas, and supporting its entry into multilateral institutions such as the WTO. The West, and in particular the EU and the US, should, in a post-Assad environment, accelerate the process of accession of Syria to the WTO. These are achievable steps that will also go a long way in calming Syrians' perception that the West is just promoting its own interests and completely disregarding Syria's.

Accession to the WTO will support Syria in its efforts to build strong and credible domestic institutions, adopt good economic policies, and provide guarantees to foreign investors against policy reversal. Importantly, accession to the WTO will also facilitate improved access of Syrian products to export markets, and help the country defend its market access rights.

As reforms take shape, Syria will need to fully engage in the promotion of regional trade and investment ties. These have proven instrumental in helping economies with their global integration strategies.

Boosting the competitiveness of Syrian industries in a changing domestic and global environment will be a key challenge for the new leaders. This may require a trade and investment policy agenda that moves gradually to open the economy first to regional partners and then to the global economy. Integration among neighbouring states can be used to assist Syria's economy in developing global comparative advantage by preparing for integration with Europe and further when Syria accedes to the WTO.

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4 Morocco and the Maghreb after the Arab Spring

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1. Introduction

The idea of closer Maghreb integration dates back to the 1960s with the Maghreb Customs Union, which was never implemented. In 1989, the Arab Maghreb Union (AMU) was established with the aim of achieving regional integration between Algeria, Libya, Mauritania, Morocco and Tunisia. The objective was to move from increased trade in goods and services to a customs union in 1995, a common market in 2000 and, eventually, a monetary union. The objectives were subsequently postponed as political tension among the member countries slowed the process. Despite some improvement in recent years, very little has been achieved so far and there is still not even an FTA between the Maghreb countries. The Arab Spring has revived the AMU and increased talks among the leaders of the five countries, but a lot of uncertainties remain regarding whether the recent developments in the Maghreb can give impetus to the AMU or will retard it.

The Arab Spring in the Maghreb countries resulted in part from one of the most pressing economic challenges in the region: the need to create jobs for youth. A new Maghreb can be part of the answer to that particular challenge. A more unified Maghreb would have a positive impact on the overall business environment and lead to an increase in the creation of enterprise. It will also increase both local and foreign investment by enlarging markets, generating economies of scale, and improving trade in goods and making necessary inputs available at a lower cost. This would not only allow an increase in trade among the Maghreb economies, but also between the Maghreb economies and the rest of the world by making Maghreb firms more competitive.

The major obstacles to the AMU are political and are related to the tensions between Morocco and Algeria. However, one question that appears to have been ignored and that may be relevant is the diverging degree of openness of the different Maghreb countries. In other words, beyond institutional and political considerations, how ready each Maghreb country is to open up to trade with its neighbours. The institutional and political environment, as well as the low degree of economic openness, might represent hindrances to the construction of the AMU. There are two main reasons why low openness might hinder integration. First, economic and trade liberalisation is a continuous and difficult process that requires both legal and institutional changes, but also strong political will and a commitment to counter the reluctance of interest groups to permit reform. Second, the diverging degree of openness might reduce the confidence of those countries that are less open in their ability to compete with firms in the more open countries perceived (rightly or wrongly) as more competitive. While Morocco and Tunisia have opened up their economies since the 1980s, the reform process in other Maghreb countries is at the early stages and may not allow countries such as Algeria and Libya to engage seriously in the construction of the Maghreb. If this argument holds, then the political considerations will have less relevance than the economic reforms. Most importantly, tariffs (see Table 1) and other trade restrictions will have to decrease in all the Maghreb economies. According to a recent study by the Association for International Affairs (2011), the level of protection in the Maghreb countries is still very high and above the one prevailing in European economies before the CEE in 2004.

Table 1 MFN tariffs applied by Maghreb countries (simple average, %), 2009

	Simple average MFN applied			Total Merchandise Imports	
	Total	Agriculture	Non agriculture	Bound Rate	Binding coverage
Algeria	18.6	23.3	17.8	-	-
Morocco	18.1	42.1	14.4	41.3	100
Tunisia	21.5	40.9	18.6	57.9	58.0
Maghreb avg.	19.4	35.4	16.9	49.6	79.0
CEE (2004)	8.2	12.2	7.6	11.3	100
ASEAN5 (2004)	7.4	10.1	7.0	22.0	78.2

Source: Association for International Affairs (2011), World Tariff Profiles 2010, WTO Tariff Database.

The Arab Spring will only facilitate Maghreb integration if it translates into a more democratic and open environment and if it creates the institutional and political framework that leads to necessary economic reforms. There is a wide range of reforms that need to be introduced in all the Maghreb countries. The more open economies, such as Morocco and Tunisia, will need to continue on their path of reform; the other Maghreb countries will have to introduce a package of economic, trade and financial liberalisation in an attempt to diversify their economies. At the same time, the availability of oil revenues could hold back the adoption of the necessary economic reforms. All the Maghreb countries will have to cooperate to introduce and increase the conformity and transparence of their regulations in order for firms in the region to feel comfortable investing and trading in the different countries. The uncertainties and difficulties of the political transitions are putting into question the ability (of course at different levels) of the different Maghreb economies to introduce the political and economic reforms necessary to revive the AMU.

In this chapter, we discuss AMU integration by giving particular attention to what it implies for Morocco. This is an important issue for Morocco because the AMU represents one of the most important opportunities for Morocco’s economic development.

The interest in the Maghreb is warranted on both political and economic grounds. Should the Arab Spring continue to bring more democracy to this part of the world, the Maghreb Union would be more inevitable. A survey conducted in 2008 in Morocco to investigate the opinion of Moroccans of the AMU and regional integration indicates that Moroccan citizens, and in particular the youth, see the Maghreb as a welcome and beneficial integration (Martinez et al. 2008). The AMU would increase Morocco's and the other Maghreb countries' attractiveness to foreign direct investment (Park 2012) and would increase opportunities for Moroccan firms to produce and trade. This would be due to the fact that the Maghreb has a relatively large population and its total GDP is non-negligible. Increased integration would also help security and stability in the region both by raising the value of common interest and by creating jobs for the growing population. Finally, increased integration would increase resilience to external shocks such as the Eurozone crisis.

Morocco has made very significant efforts to integrate with the rest of the world in the last decade. The economic and trade openness started in the early 1980s, but it was not until the mid-1990s that the association agreement with the European Community was signed and then implemented in stages. This integration process was very deep first with Europe and the US. The Maghreb and Africa were perceived at the time as important for a whole set of reasons, but not economic ones. The 2007 US and global economic crises, and the more recent Eurozone crisis, have highlighted the need to have more diversified economic partners and the Maghreb and Africa are seen increasingly as partners of strong economic relevance. Africa is no longer perceived as a hopeless continent and the prospects for growth in the continent are promising. Morocco also has a lot of complementarities with its neighbours and could benefit largely from not just proximity, but also cultural and languages similarities. There are a lot of challenges that could arise from a deeper integration of Maghreb economies but the opportunities that it would create for Morocco are also very large in a number of sectors.

Relations between Morocco and other Maghreb countries are both facilitated and hindered by relations with other major partners. On the one hand, the efforts (economical, administrative and institutional) devoted to the implementation of trade agreements with the EU and the US distract limited resources that could be devoted to the AMU, and the agreements with Europe have encouraged trade with Europe while crowding out indirectly regional integration. On the other hand, the Maghreb countries, especially Tunisia and Morocco, have liberalised their economies and have greater experience with trade and economic liberalisation. At the same time, the rules included in the existing trade agreements with the EU, such as the cumulation of origin, could facilitate integration. Morocco also cooperates with other Maghreb countries on energy, transport, banking and insurance, food and security.

The Maghreb economies are in some ways similar and in others very different. Their economic performance indicates that there was significant improvement between 2000 and 2011. The predictions for 2012 have to be considered with some caution because of the instability brought about in some of the countries by the Arab Spring. Morocco's relations with the other Maghreb countries are relatively small on all grounds when only the formal sector is taken into account. Trade and FDI are not significant and concern only a small number of goods. Immigration is relatively important between Morocco and other Maghreb economies. After Europe, North Africa is the region that hosts the largest number of Moroccan migrants. Moroccan migrants to the AMU countries represent 4.3% of the total of Moroccan residing abroad. The remittances from the Maghreb are, however, very small as compared to remittances from European countries and from other regions in the world.

In the first section, this chapter argues that the Maghreb economies can benefit from increased integration among themselves. The second section takes the case of Morocco and shows that the degree of integration of the Moroccan economy with the members of the AMU is weak, especially when compared to the integration of the Moroccan economy to Europe. The third section analyses the different agreement and the way they foster integration, suggesting that the integration process within the Maghreb cannot be achieved within a South-South model of integration where only trade aspects are considered and suggests a need to redefine the integration process. The fourth section analyses the possible impacts of the Arab Spring on the integration process, suggesting that the final impact will depend on the capacity of the different Maghreb countries to overcome the transition difficulties and uncertainties and to move quickly toward democratisation. Section five looks at some key sectoral aspects of economic integration in the AMU. The sixth section concludes.

2. The Maghreb economies: Potential benefits and constraints to increased integration

The AMU comprises almost 90 million individuals. Morocco and Algeria have a relatively large population, exceeding 30 million each, and Tunisia, Libya and Mauritania have smaller populations. The AMU as an entity represents an important market that could boost trade among the countries and create the impetus for more growth and job opportunities. The Maghreb economies are also very different; some have an excess of capital while others have a shortage of capital. They also have different sets of resources. Some are oil exporters and others are oil importers. There are some complementarities between these economies, as can be seen in the Table 2. In fact, for Algeria, Morocco and Tunisia, the trade complementarities with other Maghreb countries are smaller but comparable with those of the EU, the US or the Gulf countries. These complementarities are clearly not taken advantage of through closer integration.

Table 2 Index of trade complementarities between Maghreb countries and their main partners 2007-2009 (yearly average)

From/to	Algeria	Morocco	Tunisia	Libya	Mauritania	EU	USA	Gulf
Algeria	-	14,40	13,68	16,82	18,70	15,78	16,27	4,89
Morocco	28.46	-	38.23	33.80	31.18	37.04	37.52	32.58
Tunisia	35.96	49,13	-	48.81	50.13	49,64	54,44	39,32
EU	61.22	64.68	61.75	60.85	57.29			
USA	65.47	72.18	69.51	70.38	60.80			
Gulf	17.71	26.98	23.57*	28.60	29.05*			

Source: Abdessamad et al. (2011), calculations from the World Bank, WITS data for 2006 – 2008. The index is zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match.

These complementarities indicate that a number of potential benefits could result from increased Maghreb integration. These are highlighted by two recent studies. A recent study by the African Development Bank Group (2012) evaluates how regional integration could enhance economic development in North Africa, lays out the principal barriers to integration, and discusses changes in domestic policies and in international economic relationships, both within and beyond the region, that could further integration. The development strategies in six North African countries, including the AMU countries, need to change to reap the benefits of a more integrated region. The study aims to identify the conditions, steps and the necessary accompanying measures and action plan to create a North African Economic Community. It sees the increased integration as yielding rewards through "increased economic activity, enhanced competitiveness, more effective use of resources and the stimulus to growth and development that could flow from a much strengthened exchange of ideas, services, goods, finance and people".

The report identifies key policy changes in a number of sectors such as energy, climate change and the environment, the financial sector, trade facilitation and transport, human development and information and communication technology. An integrated energy market should be developed to respond to the need of the region. Vulnerability to climate change could be reduced through strengthening regional cooperation, reducing barriers to market-based development of renewable energy, and enhancing regional level capacity and targeted infrastructure investment for clean energy delivery. The financial infrastructure needs to be strengthened by harmonising regulatory policies, and removing market impediments to cross-border activities, particularly lifting the exchange controls between North African countries. The formal and informal trade barriers between North African countries should be reduced. The condition of the regional road network to highway standards needs to improve and port services strengthened. Cooperation on human development issues could help address youth unemployment. The region's rapidly growing ICT sector regulatory framework could be improved.

A recent report by the World Bank (2010) reviews the status of Maghreb countries' economic integration with the world, with the Arab world, and within the Maghreb. It focuses on trade in goods and services, labour and capital flows, financial integration and cross-border infrastructure integration and discusses the potential benefits of and key constraints to greater integration. The report argues that there is significant potential for trade in services (financial, transport, logistics and telecommunications) among Maghreb countries and that a combination of trade liberalisation and increased competition associated with regulatory streamlining would yield benefits that are higher than those obtained through tariff reduction alone.

Given the potential benefits from Maghreb integration, it is perhaps surprising that this has not yet been achieved. A number of reasons have been given for this. The first is the lack of political will. Another could be the way the AMU is organised and the manner in which decisions are taken.

The institutions of the Union include, next to the Presidential Council, the Council of Prime Ministers, the Monitoring Committee, the General Secretariat and the specialized Ministerial Commissions. Additional government structures include the Advisory Council[1] with headquarters in Algiers, the Maghreb University based in Tripoli, the North African Academy of Sciences in Tripoli, the Judicial Organ in Nouakchott and the Maghreb Bank for Investment and Trade in Tunis.

The main body of the AMU is the Presidential Council, which is composed of members and heads of state. It is the supreme organ of the Union empowered to make decisions. These decisions are taken unanimously by the members, and the Presidential Council has not met since 1994.

Recognising that the need for unanimity at the level of the Presidential Council for the adoption of any decision is a major impediment to the effectiveness of the AMU, the countries are considering a revision of the statutes of the AMU. Various propositions are being made, one of which is to delegate the decisions on sectoral cooperation

1 The Advisory Council is composed of thirty representatives from each country, chosen by the legislative bodies of Member States or in accordance with internal rules of each State. The Advisory Council meets in regular session each year, and in special session at the request of the Presidential Council.

to the sectoral commissions and to leave the strategic and political decisions to the Presidential Council.

Other reasons that have been put forward for the lack of success are the fact that the Treaty did not prescribe a clear roadmap with benchmarks and timelines but only long-term objectives and targets; the lack of sufficient coordination and communication among the five countries; the lack of adequate regional physical infrastructure in some of the countries; the political situation existing between Morocco and Algeria; and the need to consolidate macroeconomic stability and pursue structural reforms.

The potential benefits from Maghreb integration are badly needed if one looks at the economic performance of the AMU countries. If the Maghreb economy's performance was variable depending on the country, it was overall insufficient to meet the challenges of unemployment of the Maghreb countries. This is evidenced by the high rate of unemployment that prevailed in the AMU countries. The unemployment rate was expected to reach 18.9% in Tunisia, 9.9% in Algeria and 8.9% in Morocco in 2011. These rates show a more dramatic picture when the unemployment rate of the youth and the educated are taken separately. In Morocco, unemployment decreased in the last three years but remained very high for the urban youth and the educated. This is particularly alarming given that the youth represent a declining but still very important segment of the population. This makes the potential role of further regional integration urgent if it is to even slightly reduce the number of unemployed.

The growth performance of the AMU countries as a whole has been positive between 2000 and 2011, but the growth rate has declined in recent years and has also been affected by the Arab Spring and the unfavourable external environment with the economic and financial crisis of 2007 and the crisis in the Eurozone. In 2011, the Maghreb economies maintained positive growth except in Tunisia, where the growth rate was negative, and Libya, where the extent of disruption led to a very large decline in GDP. Algeria, Morocco and Mauritania maintained positive growth rates.

The inflation rate increased in all of the countries in 2011 compared to previous years. Some of the Maghreb economies exhibited a relatively high inflation rate (Mauritania) and others relatively low inflation (Morocco). The current account for the Maghreb region is positive with a clear distinction, however, between the oil-exporting Maghreb economies, where it is positive and high, and the oil-importing countries where it is increasingly negative. In 2011, Algeria had a current account surplus that was lower than in previous years. In the oil-importing countries, the current account shows an important deficit that is higher than in recent years. In Morocco, it reached 8%. For Morocco and Mauritania, exports have increased but imports have increased at a higher rate.

Table 3 Economic performance of AMU countries, 2011

	Algeria	Libya	Mauritania	Morocco	Tunisia
Population Persons Millions	35.954	6.479	3.543	32.187	10.655
Gross domestic product, const. prices (% change)	2.351	-59.687	3.953	4.853	-1.800
Inflation, average consumer prices (% change)	4.493	15.902	5.686	0.907	3.529
Unemployment rate (% of labor force)	9.971	--------	--------	8.912	18.900
General government net lending/borrowing (% change)	-0.195	-24.542	-1.468	-6.945	-3.202
Current account balance (% change)	9.955	1.317	-7.478	-8.044	-7.330
Volume of Imports of goods (% change)	2.888	-58.916	18.341	9.670	-6.033
Volume of exports of goods (% change)	-2.212	-78.822	41.860	5.927	-0.848

Source: World Economic Outlook (WEO) database, October 2012.

3. Trade and economic relations between Morocco and the Maghreb

The lack of success of the AMU is clearly apparent when one looks at Morocco's trade and investment data. The data indicate that Europe remains by far the most important partner of Morocco. Trade with the Maghreb is still very small, as shown by the share of exports of Morocco to its main partners and by the share of its imports from its main partners. Less than 2.5% of Moroccan exports are exported to the Maghreb and less than 3.5% of Moroccan imports come from another Maghreb country. The structure of FDI also indicates that the foreign investors are not from the Maghreb. The largest share of FDI comes from France and Spain (see Table 4).

Table 4 Trade and economic relations of Morocco with the AMU

	2000-2005	2006	2007	2008	2009	2010
Share of Morocco's exports toward main trade partners						
The Arab Maghreb Union	1.8	1.6	1.6	1.6	2.2	2.2
The European Union	73.9	71.9	69.9	56.8	64.4	57.3
India	3.5	4.0	3.9	6.8	5.2	6.0
The United States	3.4	2.0	2.4	3.9	3.1	3.6
Japan	2.6	0.8	1.0	1.1	1.2	0.7
Share of Morocco's Imports from main trade partners						
The Arab Maghreb Union	2.3	2.9	3.5	3.1	3.0	3.3
The European Union	57.8	53.1	52.9	51.5	52.1	48.6
The United States	4.3	4.5	5.9	5.1	7.2	7.0
Saudi Arabia	5.2	6.6	5.5	6.7	4.4	6.0
FDI to Morocco by country of origin						
France	57.4	33.2	37.6	37.7	51.3	55.0
Spain	21.3	27.6	16.1	9.4	6.1	7.7
United Arab Emirate	1.4	3.0	10.0	16.9	4.6	5.9
USA	2.5	3.3	4.1	3.0	2.9	1.4
UEBL	1.5	10.0	3.5	3.7	3.4	2.6
Others	16.0	23.0	28.7	29.4	31.7	27.4

Source: Kingdom of Morocco, Ministry of Finance, PLF (2012), *Rapport Economique et Financier*.

A number of Moroccans migrate to other Maghreb countries and a large number of Moroccans live in Algeria, Libya, Tunisia and to a lesser extent in Mauritania (Table 5). The Moroccans living in these countries send a very small amount of remittances, especially when compared to Moroccans living in Europe. The Moroccans living in Maghreb countries could contribute to the increased integration among Maghreb economies. Migrants look for jobs in neighbouring countries in part due to the reduction of migration opportunities in Europe, and also because the unemployment particularly among the educated urban youth is so high.

Table 5 Moroccans residing in Europe and in AMU in 2012

Region	Female	Male	Total	%
TOTAL	1,389,329	1,982,650	3,371,979	100
Europe	1,254,688	1,801,421	3,056,109	90.63
AMU	59,097	88,927	148,024	4.39
Algeria	25,989	19,462	45,451	1.35
Lybia	23,724	45,552	69,276	2.05
Mauritania	722	1,940	2,662	0.08
Tunisia	8,662	21,973	30,635	0.91

Source: Kingdom of Morocco, Ministry of Foreign Affairs, *Direction des Affaires Consulaires.*

4. What can we learn about Morocco's integration through the AMU from its integration to the rest of the world?

As shown above, the very limited role of the other AMU countries in the Moroccan economy is in sharp contrast with the potential benefits that the increased integration is expected to bring and with the important role that the EU plays in the development of the Moroccan economy. Moroccan Maghreb integration is not independent from the overall process of trade and economic liberalisation that took place in Morocco since the 1990s and in which the free trade agreement with European Community is a central piece. This is compounded by the fact that the EU has close links with other Maghreb countries and signed trade agreements with Tunisia (1998) and Algeria (2005).

The important links with Europe result from the stated goal of Morocco to take advantage of the European locomotive for economic development. This is supported by the similarities of legislation and by the fact that many civil servants and businessman are educated in Europe. The signing by Morocco of a free trade agreement with the EU as early as 1996 provided the necessary framework to deepen its relationship with

Morocco. This agreement came into force in 2000. It established a free trade area starting in March 2012. The free trade agreement with the EU includes the dismantling of tariffs and also commitments with respect to political discipline, free movement of goods, rights of establishment, payments, capital flows, competition policy and other economic measures. On the trade side, between March 2000 and March 2012, Morocco progressively eliminated tariffs on all industrial goods coming from Europe. The industrial goods originating in Morocco and exported to the EU are exempt from tariffs and equivalent taxes. The (diagonal) cumulation of origin is permitted between Morocco and EU members and between Morocco, Algeria and Tunisia.

The agreement between Morocco and the Economic Community covers a wide range of policy areas. It covers agriculture measures, non-agricultural market access, rules of origin, customs, intellectual property rights, movement of capital, state aid, government procurement and environment, competition, human rights, cultural cooperation, education and training, energy, illicit drugs and financial assistance. To implement the commitments undertaken under this association agreement with the economic community, Morocco had to pass new legislation, update existing legislation, and take certain regulatory actions. The commitments required important changes to the laws and regulations. New institutions had to be created and the existing ones were transformed. At the same time, the changes were implemented in a progressive way. The agreement also necessitated that a minimum of resources be devoted to support the liberalisation. The role of information and of a good knowledge of the relevant export requirements underlined the importance of a good level of transparency.

The development of closer ties between the actors in different sectors and the businesses led the producers to progressively gear their production towards the EU market. The reconciliation of the Moroccan legislation and practice on standards and conformity with the EU facilitated trade. The Moroccan private sector had to assimilate the manner in which business is done in Europe and to take advantage of language and communication facilities with counterparts. The role of higher education in the different countries and the exchange of students facilitated the communication and contacts of future managers. To facilitate closer integration, a modernisation of customs and indirect tax administration was introduced. There were a number of provisions to streamline customs procedures. First there was a recasting of the legislative and regulatory framework in Morocco. There was also a facilitation and simplification of procedures. The control process over imports and exports of goods was changed and the fight against trafficking was reinforced. An information system and modern inspection technology had to be introduced and partnership and cooperation had to be developed. The proper implementation of the PTA's commitment on trade facilitation necessitated a change in the legislative and regulatory framework. These changes are costly and most of the burden in terms of expenses is on the state budget and through private direct costs.

The proposed integration process within the AMU could learn a lot from the implementation of the European Community association agreement with Morocco. One lesson is that the process takes time; involves a profound transformation of the economy, of society and of the way things are usually done; is multifaceted; and can only be introduced progressively, acknowledging that it includes a lot of advantages but that come at a cost. It is also important to define exactly what type of integration is to be developed in the Maghreb and the steps required.

Moroccan Maghreb integration is also influenced by the process of Arab economic integration that is undertaken with the GAFTA and the Agadir agreement. In February 1981, Morocco signed a convention to facilitate the development of trade between Arab Countries. The executive programme of the convention was to create a Great Arab Free Trade Area (GAFTA), also known as the Pan-Arab Free Trade Area (PAFTA), by 2008. A number of the 18 members of the Arab League participate in GAFTA – Algeria, Morocco, Tunisia, and Libya included. Liberalisation was to be achieved through a 10% reduction in customs fees each year as well as the gradual elimination of trade barriers. This agreement came into force on 1 January 1998. In 2001, it was decided to speed up the liberalisation process, and on 1 January 2005 the elimination of most tariffs among the GAFTA members was enforced. According to the EU, the agreement has reached full trade liberalisation of goods through the full exemption of customs duties and charges having equivalent effect among signatory countries[2]. For the industrial sector, the agreement provides for exceptions to the tariff reductions that have to be limited in time. For the agricultural sector, tariff reductions can be suspended for up to ten agricultural products for a specified period. Non-tariff barriers remain important. The parties can choose to benefit from the dispositions of GAFTA or from the dispositions of the existing bilateral agreements[3]. The rules of origin are such that the good has to originate in an Arab country and be imported either directly or via an Arab country.[4] In addition, the Arab League has launched negotiations on services and investment liberalisation, as well as the initiative of upgrading GAFTA into a customs union by 2015.

If the record of GAFTA in terms of tariff reductions is positive, some major hurdles to inter-Arab trade persist due to weaknesses in the institutional aspects such as weak dispute settlements and the frequency of high level non-tariff barriers (Joranovic 2011). Other limitations to trade include the exceptions set on products maintained by some countries within the GAFTA, the inefficiency in implementation of the agreement's mechanisms and discrepancies in policies of support and subsidisation of local productions among the Arab countries (Kinda 2006).

Morocco is also a member of the Agadir Agreement. This agreement which was introduced in 2001 and formally signed by Egypt, Jordan, Morocco and Tunisia in February 2004, entered into force in July 2006 and has been effective since March 2007. In the Agadir Agreement, only Tunisia and Morocco are Maghreb economies. The agreement aims at eliminating both tariff and non-tariff barriers to trade between the four countries and at increasing trade and attracting FDI in the region. The

2 http://eeas.europa.eu/delegations/egypt/eu_egypt/trade_relation/agreement/index_en.htm

3 Morocco also signed bilateral agreements with the other Maghreb countries: Tunisia (1999), Mauritania (1986), Algeria (1989) and Libya (1990). These agreements are very general and are essentially preferential agreements between pairs of countries.

4 To be considered as originating in an Arab country the good has to either be entirely produced in an Arab country or have undergone sufficient transformation in an Arab country which means that the value added to the good has to be at least 40%. The origin certificate has to be signed by the authorities of the countries and is valid for four month. Full cumulation of origin among the GAFTA countries is permitted.

agreement's first planned tariff reductions of 65% in 2003, 20% in 2004 and a further 10% in 2005 were delayed and the objective to complete free trade by 2006 was not reached. All goods directly originating in the four countries, with the exception of agricultural products concerned with the preference clause and the goods prohibited for sanitary, moral or security reasons, become exempt of import duties and equivalent taxes. Industrial products are exempt from tariffs starting with the entry into force of the agreement. The agricultural and agro-industrial products will be liberalised in conformity with the executive program of GAFTA.

The agreement allows for the cumulation of rules of origin. This system would allow the free movement of goods with a certificate of origin within the EUROMED area. The rules of origin in the Agadir Agreement are pan-European. Any Arab country that is a member of the Arab League and that has signed a free trade agreement or an association agreement with the EU can become a member. On 18 August 2009, the countries that signed the Agadir Agreement signed a memorandum agreement on the mutual recognition of the conformity certificate of goods and products. Each country accepts the conformity certificate that is produced by one country and the measures of evaluation of conformity conducted by the competent institution of all the other countries.

According to Wippel (2005), "with regard to the Pan-Arab project, the Agadir Agreement could be seen as an avant-garde initiative bringing together the Arab world states that introduced economic reforms relatively early and with a comparative degree of earnestness. It did not, however, accelerate trade liberalisation, since free trade was not in force any earlier than between Arab countries and the advantage of allowing no exceptions eroded with their (theoretical) phasing out in GAFTA. However, Agadir enlarged the range of fields covered, including an earlier liberalisation of trade with services."

The coming into force of the EU-Algeria association agreement in 2005 which includes the establishment of a free trade area in stages over a maximum period of 12 years, the coming into force in 1998 of an association agreement between the EU and Tunisia providing for the establishment of an EU-Tunisia free trade area by the year 2010, the association agreement between the EU and Morocco which came into force 1 March 2000 and provided for a free trade area, the membership of Algeria, Libya and Tunisia in the GAFTA, the membership of Tunisia in the Agadir Agreement and the bilateral agreements signed between Morocco and the other Maghreb economies could, in due time, increase trade between Morocco and other Maghreb countries. The agreement between Algeria and the EU is of particular importance because, as is seen above, Algeria is not part of Agadir and joined GAFTA after the other countries.

The proximity of the AMU countries and the process of trade liberalisation between AMU and Europe and between some AMU countries within Arab regional integration could help reach a deeper integration between countries of North Africa. The role of Algeria is important due to its complementarity with Morocco, its proximity and also because of the size of its population. The objectives of the AMU would be to reach a level of integration that is more important than the one reached within other Arab agreements.

When one looks more deeply into the agreements signed between Maghreb economies within the AMU and also within other agreements such as GAFTA, Agadir and others, it is clear that these agreements fall broadly within the South-South type of agreement where emphasis is essentially on promoting trade. The agreement between Morocco and the European Community falls into the North-South type of agreement that set the integrations of the economies within a global framework that involves more than trade.

5. Potential impact of the Arab Spring on Morocco's integration to the AMU

The Arab Spring led to structural transformations in a number of Arab countries. While the forms, nature and extent of transformations differ from one country to the other, in all Maghreb countries political, economic and societal conditions have changed as a result.

The Arab Spring started with the suicide of a young Tunisian, Mohamed Bouazizi, on 17 December 2010. His suicide was followed by weeks of protests against poverty and corruption in Tunisia and led to the resignation of President Zine al-Abidine Ben Ali in January 2011. The protests and revolutionary change that occurred in Tunisia triggered a wave of similar demonstrations across the Maghreb and other Arab countries and other Arab countries, with very different outcomes materialising during the months following the Arab Spring.

The “optimism” that was apparent during the first few months of the protests was followed by more and more skepticism as some of the demonstrations and protest brought more violence in some AMU countries (Libya) and non-AMU Arab countries (Syria) and as the difficulties that the transitions were going to bring became more apparent. If the progress towards more democracy is the underlying goal, the way to achieve this goal and the steps that have been undertaken to reach it are country specific. The outcome of the path followed by the different AMU countries is more and more perceived as uncertain by external observers despite the recognition that some countries fare better than others.

Morocco appeared initially not be affected by the Arab Spring, which led some to ask whether there was a “Moroccan exception” and if Morocco was “immune to upheaval” (Maddy-Weitzman 2012). The King has a positive image among the Moroccan people and during the last 11 years has followed a policy of democratisation and emphasised the need to improve the living conditions of the poor. However, in Morocco Arab Spring-related demonstrations started on 20 February 2011. It involved the youth, non-governmental organisations using internet social networks. It took place in a number of cities and called for political reforms, increased democracy, the fight against corruption and a better distribution of wealth.

Very rapidly on 9 March 2011, the King announced in a speech a global constitutional reform to change the basic law that existed since 1996. An ad hoc commission composed of members of Moroccan society, the private sector, universities, religious organisations and civil society was formed. The commission's objective was to draft constitutional reform and to make a proposal to the king by June 2011. On that date, King Mohammed VI announced the results of the work of the commission. The new constitution was then adopted via a popular referendum held on 1 July 2011. The vote was in favour of the proposed changes. The elections of the parliament took place on 25 November 2011. The moderate Islamists from the Justice and Development Party (PJD) won the election and the leader of the PJD (Abdelilah Benkirane) has been appointed as the new head of goverment.

The commission in charge of writing the new constitution received memorandums from the different actors (political parties, socio-economic actors and civil society) and auditioned different actors to receive grievances, expectations and opinion on what the new constitution should look like. The new constitution ratified on 13 September 2011 reduced the king's powers; in particular, under the new constitution, the King has to nominate a prime minister from the largest party in parliament. It includes a number of features that increase the democratisation of the Moroccan society. Most importantly, it affirms the fundamental rights of citizens, strengthens the powers of parliament, reinforces the independence of the judiciary, provides an organic law on regions and enhances the moralisation of public life and good governance.

One of the reasons often put forward for the delay in achieving closer integration in the region is the lack of political will. This has led some analysts to see a possible link between the Arab Spring and a revival of the AMU. This revival was associated with the strong statements and various meetings which began to be held reiterating the need to revive the AMU and to increase integration. The recent meetings include the meeting of the ministers of foreign affairs in Rabat on 18 February 2012 and the meeting of the Group of 10 which brings together the ministers of foreign affairs of the five Maghreb union countries with the five South European countries (5 + 5) and was held on 20 February 2012 in Rome. The Monitoring Committee of the Arab Maghreb Union held its 47th meeting in preparation for the work of the 30th meeting of the Council of Ministers of Foreign Affairs. Interventions during the meetings called for the ratification of the FTA, ready to be signed, the resolution of rules of origin, the holding of the organizational meeting of the Maghreb Bank for Investment and Foreign Trade and the implementation of the strategy for North African support of youth issues in employment and training. The main conclusions and recommendations of this important meeting included: intensifying the coordination and consultation in connection with the holding of the next meeting of the Dialogue in the Mediterranean (a meeting of the Group of 10 which brings together the ministers of foreign affairs of the five Maghreb Union countries with the five European countries); holding a meeting of AMU member countries in Algeria devoted to security issues, coordinating the views on the Arab initiative in Syria; reiterating support for the Palestinian people; and other recommendations and decisions on economic and social development. However the most important recommendation of the meeting, which was to hold the next Summit in Tunisia before the end of 2012, was not acted upon and the meeting did not take place. It appears that Tunisia will again attempt to hold the meeting in 2013. The ministers also stressed the need to revitalize the Union structures, consolidate gains and to implement mechanisms of political consultations in order to inject new momentum to the integration of the Maghreb.

More recently, the monitoring committee of AMU held its 48th session in May 2013 in Rabat in preparation for the work of the 31st session of the Council of Ministers of Foreign Affairs, also held in May 2013 in Rabat. The meeting covered issues related to the strengthening of Maghreb security cooperation, the situation in the Sahel, the dialogue with the EU, the creation of the Maghreb free trade area and of the Maghreb Economic Community and the establishment of the Maghreb Bank for Investment and Trade (BMICE).

Other meetings were held by the Maghreb civil society organisations such as the Maghreb Employers Union, which held its first forum in 2009 in Algiers (700 participants), the second in 2010 in Tunis (1000 participants) and the third was held in October 2012 in Marrakech. The Union of Maghreb Banks, which is located in Tunis, conducted a number of studies on financial integration and on the possibility of a Maghreb monetary union. The Union of Maghreb farmers met. In all these meetings, strong statements were made by officials as to the need to revive the AMU in light of recent developments in the region.

The link between the Arab Spring and the AMU revival comes also from the fact that there is some evidence that populations in the Maghreb economies are in favour of a greater integration. An interesting survey was conducted by Luis Martinez et al. (2008) in Morocco to investigate the opinion of Moroccans on the AMU and regional integration. The main result of the study is that democratisation is necessary to revive the Maghreb. For the period of the survey, the result was that Morocco concerns were mainly social and economic. The survey shows that the priority is to introduce reforms that would improve the living conditions of the population. Regional integration is seen as an opportunity to realise these reforms. The result of the survey indicates that the hindrance to the region integration is mainly a democratic deficit and that regional integration can only be achieved through the region's democratisation.

The survey finds that, in 2008, "like in Algeria, the regional integration project is perceived in Morocco as "fuzzy" for the vast majority of respondents (64%) and negative for 16%. Only 6% of our respondents have a clear picture of the proposed AMU. Despite the seventeenth anniversary of the organisation, 84% are incapable of naming any of the AMU's achievements. This is why 67% are not satisfied with the results of integration in the region. Regional integration does not exist and our respondents confirmed this. Yet the opinion is favourable to this integration. For 69%, Morocco's future is tied to the construction of a regional integration, 64% feel personally interested in the AMU, 61% think that Morocco plays a very important role in regional integration, 72% define themselves as North African and consider that they share common characteristics such as language and religion. It revealed high expectations: 36% expect the creation of a regional market and 35% the reconciliation between peoples. But regional integration is seen as an instrument of diplomacy (28%) or as a regional constraint (23%) more than an economic interest (24%). Regional integration is seen as a promising project for 49%, it represents a challenge for economic development and 38% think that one of the objectives of the AMU should be to work towards an Economic Partnership."[5]

This survey was conducted in 2008 before the crisis in Europe, however, and it is not clear if the answers today would be different. It is possible that the depth of the crisis in Europe pushes the Moroccans to perceive the regional integration with the Maghreb as being more of a priority.

Today, Morocco's commitment to the Arab Maghreb Union appears stronger on political and economic grounds. Morocco presents the Maghreb region as a priority of its foreign policy and Maghreb unity as a strategic option. It houses the headquarters of the AMU, and participates in all meetings organised by the various institutions of the Union, and fulfills all of its obligations. Morocco has proposed the opening of borders with Algeria and its willingness to reach a political settlement of the Moroccan Sahara issue.

Despite the holding of various meetings and strong statements by the officials of the different Maghreb economies on the need to revive the AMU in light of the Arab Spring, it seems that the momentum for increased integration has declined and that little concrete progress has been achieved during the last two years. Hence, the renewed interest in the AMU sometimes associated with the Arab Spring has to be viewed with caution. Despite the change of leaders in some countries and the democratisation in others, it is not clear that the change in perceptions is sufficient to move the process forward and it is also not the first time that speeches and recommendations for increased integration have been made and not followed up upon[6].

5 Free translation from Martinez and others 2008.

6 In Ras Lanouf (Libya) in March 1991 it was decided by the head of States of the AMU that a free trade area between Maghreb countries had to be introduced and the steps to achieve this objective were defined. A strategy was defined and a date was set for implementation. A time schedule was to be elaborated through studies involving both international and Maghreb experts. A draft project including 140 articles was elaborated and discussed without producing any result. At the same time

6. Sectoral relations between Morocco and Maghreb economies

A study by the Peterson Institute (Hufbauer and Brunel 2008) analyses four sectors with high potential as catalysts for Maghreb cooperation as well as tools for development in the region. These four sectors are energy, banking and insurance, transport, and food industries. Recent developments in cooperation in the first three sectors are discussed below. They are susceptible to generating high rewards from increased integration of the Maghreb and they could be drivers of greater integration between Morocco and the Maghreb.

Energy

Cooperation in the Maghreb in energy was discussed in the ninth session of the Council of Ministers in charge of Maghreb energy and mines, held in Rabat on 8-9 November 2010. Specific actions concerning capacity building, exchange of expertise, data and information dissemination, joint studies, consultation and coordination, legislative approximation, as well as actions related to regulation of energy markets, strategic planning, integration of energy markets, electrical interconnections, exchange of petroleum products and industrial integration and investment promotion were identified and planned during this session (Zniber 2012).

Another area of Maghreb cooperation is the Mediterranean Solar Plan of Union for the Mediterranean, which should foster the large-scale development of renewable energy in the south and east of the Mediterranean, to facilitate exports of green electricity to Europe, but also to meet their projected deficit of drinking water through desalination of seawater. There is also the project of "progressive integration of electricity markets of Morocco, Algeria and Tunisia to the electricity market of the EU", supported by the European Commission.

The 5+5 cooperation on environmental protection and energy is important. In this regard, the Declaration of the first Ministerial Conference on Environment and Renewable Energy Dialogue held in Oran on 26 April 2010, contains important provisions for cooperation between countries in the region.

Cooperation and partnership has increased over the last few years between Morocco and Algeria. For trade in energy products, Algeria is Morocco's sixth provider. Morocco and Algeria's cooperation on energy also includes the strengthening of the electrical interconnection by building a third line of 400 KV established in October 2009; the signature on 3 July 2008 by Office National d'Electricité (ONE) and SONELGAZ of two contracts to set the terms of exchange of electricity between the two countries; and the signature in July 2011 by the ONE and Sonatrach of an agreement to sell 640 million m3 of natural gas in Morocco over a ten-year period, which will be routed through the Maghreb-Europe gas pipeline. In mining, the cooperation dealt with the exchange of experiences in research and development of mineral deposits, geological mapping of the border areas, and strengthening information exchange and expertise. In the water sector, the visit to Morocco in 2011 by the Algerian minister of water resources has given new impetus to cooperation between Morocco and Algeria. Cooperation in this sector was consolidated and organised by the signature on the 18 March 2011 of a memorandum of understanding establishing a technical committee on bilateral cooperation in the field of water resources.

Transport

According to a study by CETEMO (2010), delays in regional integration adversely affect the Maghreb logistics sector. This threat affects all AMU countries and the smaller economies, such as Tunisia and Mauritania, suffer more from such delays. In the case of Mauritania, Maghreb integration is more necessary because of its peripheral location and the need to consolidate its role as a link with sub-Saharan Africa. A number of ports are under construction in Tunisia (Enfidha), Libya and Algeria (the port of Djen-Djen which will compete most directly with the port of Tangiers) and there is thus a risk of overcapacity in the port system. The impact on national logistics systems needs to be studied to underpin and enhance complementarities. The delay taken to develop the potential complementarity between logistics in AMU countries could be favourable to other competing areas such as eastern Europe or the eastern Mediterranean. The lack of integration between Maghreb countries and in particular the difficulty to penetrate the Algerian and Libyan markets hinders Tunisian operators and reduces their chances to take advantage of their larger international experience to achieve greater profitability. The low integration in the region weakens the position of Moroccan companies in the logistics sector.

The Moroccan Governing Council adopted on 5 May 2011 the cooperation agreement in the maritime field between the member countries of the Arab Maghreb Union (AMU), signed on 23 July 2009. This aims to facilitate trade between the countries of the AMU through a unified policy in the field of shipping, ports and transport logistics. It also seeks to develop the maritime sector to meet the Maghreb trade demands, strengthen cooperation in the field of protection and the fight against marine pollution, and encourage coordination in the field of maritime safety, vessels and port facilities. Under this agreement, presented by the minister of foreign affairs and cooperation, the boats of the signatories are authorised to transport passengers and goods from the ports open to international trade. The joint operation of shipping lines is encouraged as long as the boats of the contracting parties enjoy the same freedoms of entry and exit from ports; the use of all facilities should not go against local laws of member countries.

The Government Council also adopted the convention on the North African road transport of hazardous materials on 3 May 2011. This agreement was signed on 23 July 2009 in Sirte, Libya. The convention aims to strengthen and facilitate road transport of hazardous materials through the development of rules and criteria for road transport of these materials to prevent hazards and inconvenience that may result to persons, property and the environment, the aim being to encourage maximum public safety.

Banking and insurance

According to a study by the African Development Bank (2010), regional financial integration within the Maghreb could yield benefits by providing a powerful incentive for domestic financial reforms, by increasing the efficiency and profitability of the financial institutions, by increasing their scale of operations, and by ensuring the survival and growth of financial institutions into regional and global players. The banking and insurance sector are not fully integrated and exchange controls exist on capital transactions between the five Maghreb economies. There is some degree of harmonisation of regulation that results mainly from the introduction of international standards in the banks and non-bank financial institutions.

In all of the five AMU countries, banks are the main actors in the financial sector. They control an important proportion of financial assets. These banks are for the most part public banks in Algeria and Libya, and for the most part private in Mauritania, Morocco and Tunisia. Foreign banks are present in the Maghreb economies and account for a non-negligible share of total assets. The Moroccan financial sector has undergone important reform and is faring better than the other Maghreb countries. Moroccan and Tunisian banks have branches in Europe and Morocco is increasing the number of branches in Africa.

Libya and Tunisia have a bilateral currency convertibility arrangement and Algeria, Morocco and Tunisia have some convergence in real effective exchange rates. The North African banks are located in the different AMU countries. Moroccan banks such as BMCE and Attijariwafabank are present in other Maghreb countries. Tunisian banks, such as Tunisia Leasing and Amen Bank, are present in Algeria. The Libyan banks, such as the Banque Tuniso-Libyenne, and the Algerian investment bank International Market Bank are present in Tunisia. Morocco has the most developed insurance sector in the Maghreb. It includes insurance and reinsurance. There is a high concentration with three companies dominating the sector.

7. Conclusion

The Arab Spring resulted from a desire of the citizens for more voice, dignity and jobs. Many observers believe that an increased integration of North African economies would help create jobs for the citizens of the region by raising security and stability, by attracting investment and improving trade. Since the Arab Spring, various initiatives have been undertaken to revive the AMU. These include the holding of various meetings leading to strong closing statements calling for the revival of the AMU and the strengthening of ties among members of the civil society. These developments are undermined by the varying degrees of trade and economic openness of the Maghreb economies.

Morocco and the other Maghreb economies are complementary and there are substantial potential gains from Maghreb integration. The very limited interaction between Morocco and other Maghreb countries contrasts with the possible benefits. Morocco has nonetheless demonstrated its commitment to economic and trade liberalisation. Morocco's association agreements with the European Community, its free trade agreement with the US, its membership to GAFTA and to Agadir all have implications for the construction of the AMU. The North-South agreements that Morocco concluded redefined its production processes and directed its resources towards the implementation of these agreements. The fact that association agreements also exist between the EU and Tunisia and Algeria can facilitate Maghreb integration. Morocco's membership to GAFTA to which Algeria, Libya and Tunisia are a party and to Agadir, to which Tunisia is a party, also influences AMU.

The outcome of the Arab Spring is uncertain and the transition might hinder the adoption of political and economic policies that would permit greater integration. The Arab Spring will only facilitate Maghreb integration if Maghreb countries are able to increase democracy and to adopt the structural economic reforms necessary to liberalise the economies and allow them to become more competitive. It would also need to remove some of the constraints to AMU construction and which include political will, the way AMU is organised, the communication among AMU countries and the political situation among Algeria and Morocco and the lack of infrastructure. It appears difficult to remove all these constraints in the short term.

The Arab Spring brought more democracy to the Maghreb and new government. The challenges that existed before the Spring remain, most notably the need to create more jobs for the whole population and for the youth. The way the new governments address these challenges might differ; one way could be via a greater Maghreb integration. The momentum that existed at the beginning of the Arab Spring seems to be vanishing and little has been achieved. The Maghreb countries will need to show strong political will and vision to overpass the actual hindrances and difficulties and to move toward greater regional integration. They will also have to continue work to develop sectors that are drivers of greater integration.

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5 Harnessing existing trade and investment opportunities

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Introduction

Economic integration, both with neighbours and the world more generally, has proven to be a basic feature of all sustained high-growth experiences in the post-1950 period. Economies that have grown at an average rate of 7% or more per year for 25 years or longer all increased their overall productivity through trade, foreign direct investment (FDI) inflows, and the acquisition of technology and knowledge through education abroad, reverse engineering, spillovers from imports of machinery, learning by doing, and exchanges of ideas more generally. These various channels of engagement with the global economy allowed firms and households to use already available knowhow and techniques to improve living standards.

All successful experiences of integration had to take their external environment, and in particular the external market access conditions they faced, as a given. Successful countries made the most of the global economy, despite numerous trade and investment barriers that restricted access to foreign markets. Trade policies in major markets helped some countries and constrained others – for example, the web of restrictions affecting exports of textiles played a role in jump-starting production in some countries – but for all the dynamic developing and transition countries, what drove export growth was the ability to excel at harnessing prevailing trade and investment opportunities.

1 This paper draws on previous work by the authors and various co-authors and colleagues. The views expressed are personal and should not be attributed to the World Bank.

Greater integration into the international economy is a key means through which MENA countries can reap the benefits of already existing market opportunities to accelerate economic growth and job creation (Chauffour 2013). Excluding petroleum exports, the MENA region, with over 400 million people, exports roughly the same amount as Switzerland. The potential for improvement is therefore almost unlimited. The Arab market itself offers considerable untapped potential for intra-regional trade (Malik and Awadallah 2011, Hoekman and Sekkat 2010). With a population of over 500 million, the EU represents a market estimated at 20% of global GDP when measured in terms of purchasing power parity. Once Turkey and the other new growth poles in Asia, Africa and Latin America are taken into account, Jordan, Lebanon, Tunisia and other countries in the MENA region with relatively small domestic markets are faced with an almost unlimited external demand.

A necessary first step to conquer international markets is to open the domestic economy. As is well known, a tax on imports is ultimately a tax on exports. The emergence of global value chains and international production networks that imply that goods cross borders a number of times before reaching the final consumer has rendered obsolete the traditional policy of using trade protection to support import-substituting industrial development (Baldwin 2011). As is true for trade in goods, a country cannot become a major services exporter unless it is open to services imports. Opening up trade in services, if implemented in conjunction with an appropriate regulatory and competition policy environment, can help remedy supply-side constraints and increase productivity of all firms in an economy by generating more, better and cheaper services. A country not open to trade in services automatically not only excludes itself from a significant part of world services trade, but also significantly increases its trade costs to the detriment of its competitiveness and excluding itself from participating in global value chains and international production.

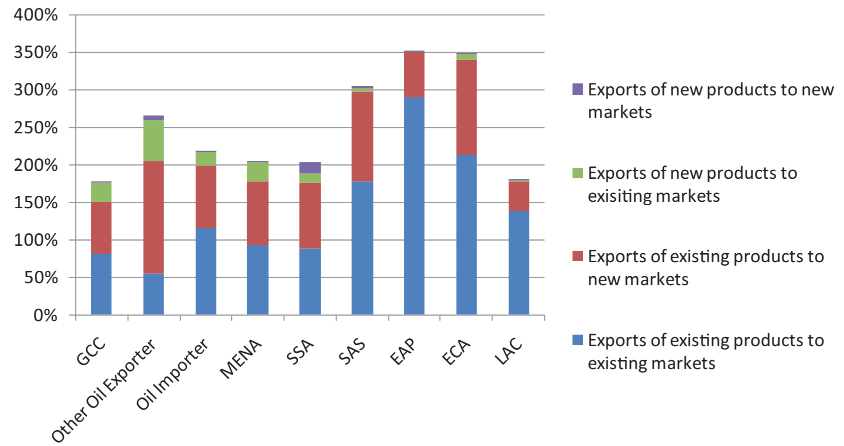
Integrating into global markets is not just a matter of reducing barriers to trade applied at the border. The recent experience with trade liberalisation in many MENA countries illustrates that an effective economic integration strategy requires complementing reductions in trade barriers with policy reforms to ensure that markets become more competitive (contestable for new entrants) and that operating and transactions costs for firms fall. It is important to recognise that much was done to reduce barriers to trade in the MENA region in the last 15-20 years. Significant progress was made over the last two decades in many Arab countries to lower import tariffs and other explicit trade restrictions. Tariffs in Egypt, for example, were reduced to less than 10% on average, down from over 40% in the late 1980s, most quantitative restrictions removed and the trade regime greatly simplified. Similar reforms were implemented in other Mediterranean countries. This stimulated an increase in exports of non-traditional products and greater diversification of the export base in a number of countries. Many countries also saw an increase in trade in services. Greater inflows of FDI were one driver for the increase in trade, especially in the last decade.

However, the positive supply responses to trade reforms were limited as a result of the continued dominant role of the State in most Arab economies (World Bank 2009). Barriers to entry for new firms and high costs of investment in new activities resulting from a plethora of regulatory impediments and state control resulted in less job creation and economic dynamism than has been observed in other parts of the world following policy reforms to open the economy to foreign goods and services.

Trade performance

In 2008, MENA's share in world exports of non-oil goods and services was only 1.2%, up from 1% in 1998 (World Bank 2011). During that ten-year period, the region's share in world exports of services grew by nearly 30%, double that registered by other middle-income countries (excluding China). The out-performance was offset by underperformance for exports of non-oil goods, which registered an increase of only 17%, well below the 26% attained by the comparator group of middle-income economies. Regional export growth was driven mostly by an expansion of existing products to new markets and new products to existing markets – that is, along the extensive margin (see Figure 1). The dominance of the extensive margin can be explained partly by declining sales to a number of traditional export markets in Europe (Brenton et al. 2010), but is also an illustration of a gradual increase in participation in international production-sharing arrangements in sectors such as motor vehicles (Tunisia) and chemicals (GCC oil exporters).

Figure 1 Non-oil merchandise export growth by region, 1998-2008 (in value terms)



Source: World Bank (2011).

Behar and Freund (2011) conclude that a typical MENA country exports less than half, and as little as one quarter, of its potential, controlling for standard determinants of trade such as country size, income and distance to partner markets. Similarly, Bhattacharya and Wolde (2010) also find that a typical MENA country exports much less than what it should given fundamental trade determinants, although imports are much closer to what would be expected.[2]

The major reason for the underperformance is the cost of doing business in the region, part of which reflects trade costs. Of course, other factors also play a role. Thus, for some countries real exchange rate overvaluation as a result of Dutch disease dynamics impeded greater export dynamism (Diop et al. 2012). More generally, however, trade

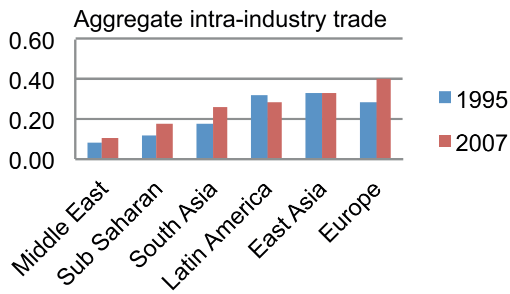
2 This is a well-established result in the literature (see, for example, Harb 2008 and Péridy 2007).

reforms in many countries, while significant in an absolute sense, did not go far enough to keep up with what other countries elsewhere in the world were doing in removing barriers to trade and lowering trade and other operating costs for firms. Trade potential and growth is increasingly determined by the level of the trade costs that affect supply chains. The continued prevalence of high 'red tape' costs associated with moving goods and services across borders in Arab countries – especially in comparison to 'competing' countries in Central and Eastern Europe – and dominance of the State in the economy limited the positive effects of tariff reduction.

It is almost a platitude that the structure of the world economy has changed dramatically in the last 20 years. Products are increasingly produced in regional or global value chains, with value being added to a product by firms located in different countries. Much, if not most, of the value that is embedded in products reflects services such as design, marketing and distribution, as well as labour. The geographic fragmentation of production is reflected in the increasing vertical specialisation of trade, with firms in countries producing an input that is exported and used in further processing of a product in the importing country, which may then be exported to a third country, and so forth. It has been estimated that some 30% of all trade today is vertical in nature (Daudin et al. 2011). A large share of this trade is also intra-firm – involving exchanges between plants that are part of the same company. That in turn implies that such trade is closely linked to FDI, and that barriers to FDI will constrain the ability of a country to participate in global supply chains.

A striking feature of the MENA region as a whole is that it participates to only a very limited extent in supply chains. The composition of exports varies widely across Arab countries as a result of oil. For countries that are importers of oil, exports of manufactured and agricultural goods and services accounted for 38% of GDP, which is quite high compared to other developing regions. But these exports are largely for final consumption, they do not comprise of goods that are processed further in the destination market.

Figure 2 Intra-industry trade index by region



Source: Behar and Freund (2011).

One very crude measure of vertical specialization is intra-industry trade (IIT): imports and exports of similar products. Analysts have pointed out for many years that levels of IIT for MENA countries are very low (Havrylyshyn and Kunzel 2000). This has continued to be the case in the recent period. IIT was rising during the 2000s, but remains far below what is observed in other regions; indeed, IIT levels are the lowest of any region (Figure 2). Tunisia has been most successful in integrating into production networks and has the highest share of IIT in the MENA region (40%), followed by Morocco and the UAE. The only country in the region with a significant share of components in its total exports – a key feature of vertical specialisation – is Tunisia, which saw the share of parts and components in total exports expand from less than 4% in 1985 to 10% in 2006 (Behar and Freund 2011).

There are many reasons for the extent to which the region lags behind on this measure of economic integration and specialisation. In part, it is simply a reflection of endowments – oil. But as is illustrated by the case of the UAE, natural resource dependence need not imply that there is no scope for diversification; the UAE has become a major exporter of distribution, logistics and transport services (Ianchovichina 2011). The main reason for the lack of change in IIT is the level of trade costs in many countries. The costs are in part a result of trade policies – for example, restrictive rules of origin (Gasiorek 2008) – but the most important determinant of such costs are administrative procedures and requirements – what is often called 'red tape'.

The major reason for lacklustre trade and employment performance in comparison with other developing countries is an overall lack of competitiveness. Competitiveness is central to harnessing private-sector growth for sustainable employment, poverty reduction, and, ultimately, wealth creation. Firms, especially small- and medium-sized enterprises, serving both export and domestic markets cannot exploit opportunities if they are burdened by costs outside their control that make them uncompetitive. Increasing the number and value of products produced, the number of markets served, increasing new investment and the survival rate of firms are all conditional on lowering such costs. Following the recent disruptions in economic activity and decline in export revenues, an increase in investment is urgently needed. To encourage new entry and expansion of existing firms, economy-wide policies to improve the business environment and investment climate are needed.

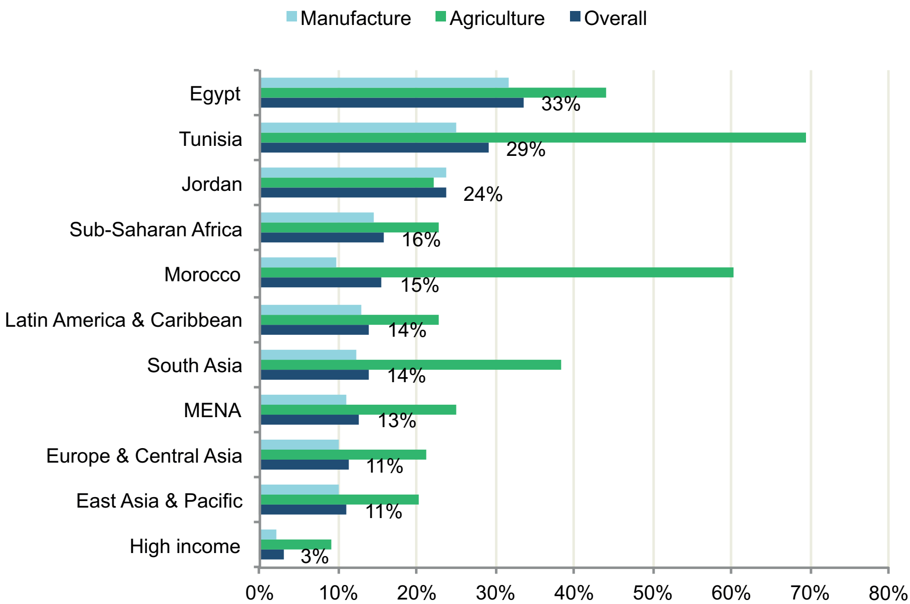
Priority areas for further reform

There are arguably two over-arching priority areas for trade-related reforms: (a) improve market access opportunities and related regulations; and (ii) lower trade costs and improve “connectivity” for firms.

Market access in the MENA region is quite restrictive, particularly for exporters from Latin American and sub-Saharan African countries. Notwithstanding the progress made in the last decade in reducing tariff rates, the overall level of tariff and nontariff protection in the MENA region vis-à-vis the rest of the world remains relatively high by international standards , especially for agricultural products (Figure 3). In particular, the region compares unfavourably with its main competitors in Eastern Europe and Central Asia, Latin America and the Caribbean, and East Asia and the Pacific – the new dynamic poles of the world economy.

Significant progress has been made in reducing tariffs on goods in MENA. Over the last decade, preferential liberalisation under PAFTA and other PTAs has been complemented by reductions in MFN tariffs. As a result, the average uniform tariff equivalent of all tariffs (ad valorem and specific) for the region fell from some 15% to 6% between 2002 and 2009. Surveys of trading enterprises suggest that tariffs are no longer seen to be a major impediment to trade (Hoekman and Zarrouk 2009). What distinguishes trade policy in a number of MENA countries from other developing and emerging markets is the prevalence of non-tariff measures (NTMs) and associated enforcement and compliance costs. As a result, the overall trade restrictiveness of non-oil exporting countries in the region is higher than in most other countries (Figure 3).

Figure 3 Overall trade restrictiveness index by region, 2008



Source: World Bank and UNCTAD staff estimates.

Econometric studies suggest that the gap introduced between domestic and world prices for a given product as the result of NTMs is typically large in countries for which data are available (e.g., Morocco, Tunisia), especially for agricultural goods (Augier et al. 2011). Progress has been made in streamlining NTMs over the last two decades, with the virtual abolition of instruments such as quantitative restrictions, prohibitions, and price controls and a great increase in the use and incidence of technical regulations and product standards. Key remaining hurdles are procedural requirements and administrative processes that result in delays and high costs of compliance.

Tackling costs associated with inefficient trade facilitation and logistics is central to further integration of Arab countries, both regionally and globally. The costs of "connectivity" are often fixed, and as a result they disproportionately affect small firms, farmers, and the poor, severely limiting their participation in trade and investment. Reducing the costs associated with moving goods along international supply chains, whether these costs are measured in terms of time, money, or reliability, is a core element of any trade and FDI agenda.

Based on the results of a survey of trading firms, Hoekman and Zarrouk (2009) conclude that tariffs have mostly been removed on intra-PAFTA trade and that customs procedures are now perceived to be much less of a problem than in the late 1990s. In 2001, tariffs were ranked as one of the most important barriers to intra-regional trade; in 2008 they were ranked last. Instead, transport-related infrastructure and real trade costs (trade facilitation) were ranked as the most important constraints. These results support recent analytical studies that conclude that the magnitude of Arab trade flows is significantly lower than it would otherwise be because of high real trade costs (e.g., Behar and Freund 2011; Bhattacharya and Wolde 2010; Harb 2008; Péridy 2007; Zaki 2010, 2011).

Bourdet and Persson (2011) estimate that improving export and import procedures to the best practice level prevailing in the region is likely to increase the value of non-EU Mediterranean exports by 34% and to increase the number of products exported by non-EU Mediterranean countries by 21%. If exporting non-EU Mediterranean countries reached the level of efficiency in export procedures that the best EU countries have, total exports from the countries analysed would increase by 40% on average. Computations of bilateral trade costs for MENA countries indicate that, as compared to the EU, trade costs are typically twice as high in the region, especially for trade between

Arab countries (Arvis and Shepherd 2012). Maghreb countries have lower trade costs with Europe than between themselves (Table 1). Since trade in the Mediterranean region mainly takes place within single markets (e.g., the EU, GCC) or through preferential arrangements (e.g., Euro-Med Association Agreements, PAFTA, Agadir agreement), the cost differentials relate mainly to distance, trade logistics, facilitation issues, and the existence of non-tariff measures. Trade costs are consistently higher for agricultural products. This reflects the higher transportation costs (per unit value) and time sensitivity of perishables, but also potentially the impact of more controls at the borders and non-tariff measures. In short, MENA's geographic advantages in terms of connectivity to major markets such as the EU are more than offset by weaknesses in trade facilitation and logistics.

Table 1 Bilateral trade costs for industrial products (%)

	Maghreb	Mashreq	GCC	Egypt	France/Italy/Spain	Greece
Maghreb	95	152	167	126	75	151
Egypt	126	112	111		119	163
Mashreq	152	77	96	112	149	185
France/Italy/Spain	75	149	132	119	50	96
Greece	151	185	169	163	96	
GCC	167	96	69	111	132	169

Source: Shepherd (2011).

The main trade logistics bottlenecks reflect "soft infrastructure" constraints, such as customs and other border agencies, trade and transport facilitation frameworks, and trade logistics services providers.[3] Container dwell times in Morocco or Tunisia are about a week, which is substantially more than the OECD average (3 days) and also exceeds those of emerging economies in Asia (Malaysia has 4 days, and transit time in Shanghai is 2.5 days). Markets for logistics services, including trucking, are fragmented by country, with many small providers and few incentives for consolidation and efficiency gains. There are relatively few active corridors between MENA countries.

3 The following paragraphs draw on World Bank (2012).

Prior to the Arab Spring, the most active corridors were Tunisia-Libya, Turkey-Syria-Jordan, and Jordan-Iraq, as well as corridors within the GCC. Apart from the Tunisian-Libyan experiment at Raz Jair, there is no cross-border coordination between countries (a joint border post, for instance), and there is often a wide no-man's land between posts, if not an outright border closure. There are typically many controls on each side of a border, including for security purposes.

Countries have much to gain from improving sub-regional trade corridors and regional trade facilitation frameworks. In most trade corridors, existing or projected investment in infrastructure will not deliver benefits without effective transit systems. The efficient movement of goods and vehicles across borders and overland for long distances relies on having in place a seamless transit system at the regional level, or at the very least between neighboring countries. While various formal regional and bilateral agreements are in place, implementation is often jeopardised by poor cross-country cooperation. In larger countries such as Egypt, the performance of internal corridors is also a key priority for reducing poverty in lagging areas and addressing rising concerns about development disparities within the country. Measures to improve internal logistics performance to improve connections to international trade corridors and supply chains are just as important, if not more so, than action at the borders.

A large part of the competitiveness reform agenda revolves around improving the operation of markets for services. Trucking services are an example. Informality and relatively short distances prevent the emergence of a network of high-quality medium-sized transport operators, which has implications not only for logistics but also for road safety and urban management. Intermediary professions (e.g., brokers, agents) also tend to be very fragmented, with insufficient quality control, while nationality requirements for brokers (except in Morocco) favour a small number of well-connected domestic operators. Yet reforms are possible. In 2007, Jordan implemented an innovative loading-by-appointment system at the port of Aqaba, which forced truckers to operate in formal companies. This transformed the market structure of trucking operations in the corridor serving Amman and Iraq. Morocco has also promoted the development of new logistics services for the manufacturing industry, operating in parallel to the "old" fragmented trucking and brokerage sector. The reform involved developing logistics zones (e.g., Tangier, Casablanca), opening up the sector to FDI, and installing new customs regimes suitable for logistics activities (World Bank 2012).

More generally, services trade, whether embedded in goods or stand-alone, represents an important source of diversification and growth potential for Arab countries. As already noted, services exports before 2010 were growing more rapidly than merchandise exports, which were often low-value-added industrial goods, confined to the bottom of the productivity chain as emerging countries moved up the value ladder. In the past decade, the share of services trade in GDP doubled on average, and almost tripled in the case of Egypt (World Bank 2011). Egypt, Morocco, and Tunisia rank among the world's 30 largest net exporters of services (in value), helping to partially offset merchandise trade deficits. However, services exports have been mainly concentrated in transport and travel, that is, tourism. Travel alone represents 50% or more of the services exports in Egypt, Jordan, and Morocco, and close to 50% in Tunisia, compared to an average of 25% or less for the rest of the world. The share of exports of other types of services, such as business and communications services remains well below the world average.

Barriers to trade and investment in services sectors often are significant in the region (Bottini et al. 2011). Expanding production and exports of services will often require FDI, and thus liberalisation of access to services markets for foreign firms. In MENA, FDI started increasing at a rapid pace since 1995. Indeed, net FDI inflows as a share of GDP were highest in MENA compared to other regions in the world (Table 2), illustrating how market reforms, after a time lag of two to three years, can raise the profile of an economy and bring it to the attention of investors, leading to FDI projects, new economic activities, and jobs. While the global flows of FDI tripled in the decade preceding the 2008 global financial crisis, those going to the Arab economies increased at an even higher rate, albeit from a very low level. However, except for tourism, FDI outside the energy sector was mostly directed to non-tradables, with little going to export-oriented manufacturing or high-tech services (World Bank 2011).

Table 2 FDI has grown rapidly in MENA (% of GDP, net inflows)

	1990	1995	2000	2005	2008
EAP	1.57	3.9	2.64	3.46	3.33
ECA	..	1.06	2.16	3.07	4.44
LAC	0.74	1.73	3.93	2.74	3.01
SAS	0.14	0.63	0.72	1.08	3.31
SSA	0.41	1.4	2	2.94	3.47
MIC	0.78	1.97	2.71	2.88	3.51
World	0.99	1.13	4.83	2.55	3.04
MENA	0.22	0.31	1.22	2.57	4.57

Source: World Bank, WDI.

The pattern of FDI inflows points to a set of political economy, policy, and regulatory factors that are constraining the realisation of fully benefiting from globalisation. Addressing these issues is within the power of national authorities, and doing so could position Arab economies to take greater advantage of FDI for economic and social development of both their respective countries and the whole region. The manufacturing and services sectors, where most jobs are generated, have not been able to attract their shares of FDI, compared to the petroleum and real estate sectors. The limited investments received in manufacturing and services have generated little local added value because of impediments to spillover effects on the host economy.

Looking forward, political, social, and legal stability will be a key prerequisite to attract more investment, whether of Arab or other origin, and to persuade investors to establish and expand their businesses. Equally important, investors need markets and compelling business opportunities to invest in those markets. Streamlining current restrictive investment regimes and adopting a timetable for phasing out restrictions on foreign equity participation in all economic sectors, except for a short and clearly defined negative list, would create new opportunities for private investors, especially in critical economic sectors such as banking and insurance, electricity, and transport. Opening up to foreign investors would entail completion of privatisation programmes and establishing a level playing field in all economic sectors, including improving access to production factors (industrial land, foreign exchange, and credit). The payoffs are likely to be considerable. According to the Jordanian authorities, privatisation and regulatory reforms in the telecommunications sector in the mid-2000s generated 25,000 additional jobs. Barriers to the process of "creative destruction" in Arab countries are enormous. The average firm in the MENA region is almost ten years older than the average firm in East Asia or Eastern Europe. Croatia's working-age population is comparable in size to Jordan's, but the average number of newly registered firms in Croatia was almost five times higher in 2004–2009 (World Bank 2012).

Conclusion

No country in the last 50 years has sustained high levels of growth and significantly increased per capita incomes without greatly expanding trade and investment. Although countries in the MENA region made significant progress in the last decade in reducing tariffs and other barriers to trade, the regions' share in world exports of non-oil products has remained flat. Excluding the oil sector, the region remains one of the least integrated in the world, both in terms of intra-regional trade and integration into global production networks. Investment has been deterred by relatively high trade and investment barriers – while governments did pursue trade reforms, these lagged behind the depth and speed of opening of markets observed in other regions of the world. Real trade costs, including the impacts of poor trade facilitation and logistics services, remain higher than elsewhere. Intra-regional trade agreements among Arab countries and with the EU did not address some of the basic drivers of high trade costs and the constraints that impeded investors from establishing or expanding production facilities.

A critical factor that explains the disappointing supply response to reforms implemented in the past decade is the lack of growth of the private sector. There are huge opportunities to harness existing trade and investment opportunities for growth and employment. The challenge is to establish conditions that will encourage entry by new enterprises and expansion of existing firms. As argued by Malik and Awadallah (2011), there is an important political dimension to addressing this challenge as a precondition is a willingness to accept the associated redistribution of economic rents and influence away from the State and entities with close ties to the State (World Bank 2009). Completing trade and investment reforms, including regulatory simplification and reforms of NTMs is an important element of allowing such a change to occur, but it is only a part of what is needed to allow a vigorous, competitive market place to emerge in countries in the region.

The importance of deepening economic integration in the MENA region is a core element of the diagnostic and the recommendations of a recent World Bank report on trade and FDI prepared for the Deauville Partnership (World Bank 2012). The implementation of far-reaching domestic reforms in MENA countries is vital to realise the growth and associated employment opportunities offered by access to neighbouring markets and those in the rest of the world. To confront and adapt to the rapidly changing global trade landscape that is driven by specialisation and participation in global value chains and vertically integrated production networks, MENA countries need to improve their competitiveness across the board – including in critical areas such as innovation, business sophistication, financial development, and overall economic governance. Thus, the policy reform and investment agenda goes far beyond the trade cost-related factors that were the main focus of this note. But trade integration should figure prominently in future policymaking, including a concerted focus on realising the long-standing vision of greater regional integration of the Arab world.

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6 Non-tariff measures: Regional cooperation and competitiveness through regulatory governance

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Introduction

Resource-poor Mediterranean countries (RPMC) are engaged in a race against time to employ large cohorts of young people entering the labour force each year. So far, job creation has fallen substantially short of what would be required to ensure anything close to full employment, giving a sense of urgency to the search for new policy directions.

Whether export-oriented sectors, be they manufacturing or services, can radically change the picture on the region's labour markets in the next few years is very much an open question. Retaining price competitiveness on world markets requires constant improvements in productivity, and those are not necessarily conducive to employment growth unless volumes grow even faster.

Moreover, constraints to the region's competitiveness are well-known: against countries with rock-bottom labour costs like Bangladesh, RPMCs stand little chance in mass-produced, labour-intensive products like basic garments. Against technology powerhouses like India, they struggle to carve a niche in skill-intensive IT-enabled services. RPMCs are neither labour-abundant nor skill-abundant – they are stuck

1 This chapter draw on a working paper entitled "Non-tariff measures in the MNA region: Improving governance for competitiveness", by the same authors, forthcoming as a World Bank MNA region discussion paper.

near the middle.[2] These uncertain patterns of comparative advantage, combined with exchange-rate policies that have failed to deliver strong competitive advantage, have deprived MENA countries of the benefits of their liberalisation efforts, undermining support for further reform and creating a danger of policy reversal.

However, RPMC exporters also have a key source of competitive advantage – their proximity to a large high-income market. Gravity equation estimates have repeatedly shown that in spite of secular declines in transportation costs, world trade patterns remain largely regional. Exporters in faraway production sites like Bangladesh also report, in interviews, that physical and cultural distance are challenges in fashion-oriented sectors with strong time-based competition, where MENA exporters have a chance.

In order to leverage this competitive advantage, RPMCs must put in place policy and regulatory environments organised around a single goal: ensuring the competitiveness of export-oriented industry clusters. Recent empirical research shows that, across countries, the bulk of exports is accounted for by a small number of large firms.[3] Such large exporters can be either domestic firms that have grown and "cut their teeth" on a tough, competitive domestic market, or foreign-owned firms that directly invest on a large scale. In both cases, albeit for different reasons, the domestic regulatory environment is key. In order to attract foreign investors, it must be perceived as fair, transparent, and "programmable". In order to be a breeding ground for export champions, it must deliver the right incentives for quality and tight, professional management.

In spite of longstanding efforts to streamline the region's regulatory environments and to harmonise them with that of the EU, they remain very idiosyncratic. Non-tariff measures (NTMs) combine with many other factors to make domestic markets cosy

2 According to UNCTAD data, the median capital/worker endowment around the world was $34,887 in 2007, the last available year. Tunisia's was $37,945, Morocco's $24,038, and Egypt's $15,281. These capital stocks have been estimated by the PIM with a depreciation rate of 7%, which may lead to underestimation; however, the ratios are unlikely to be affected. In terms of human capital, the median number of schooling years per worker around the world was 8 years in 2007, versus 5.98, 4 and 5.8 respectively for Tunisia, Morocco and Egypt.

3 See Easterly et al. (2010) or Freund and Pierola (2011).

places where competition has more to do with political connections than managerial acumen, where new competitors are less than welcome, and where bureaucratic hassle and corruption encourage the development of survival skills that are of no use in world markets. This must change, and the agenda for NTM streamlining outlined in this chapter is designed to provide an entry door to the broad regulatory reforms that are required.

The stakes are high. Streamlining NTMs is not just about eliminating a few nuisance regulations or cutting the number of forms needed to clear merchandise at customs. It is about putting in place governance mechanisms that can both improve regulatory environments and prevent the use of NTMs as trade barriers. Trade barriers monitoring by the World Bank's trade division suggests a recent rise in the use of NTMs to curb imports around the world. Their high obfuscation power and the imperfect disciplines to which they are subjected at the WTO makes them good – if inefficient – surrogates for more traditional protectionist instruments.

Given the permanent danger of reform reversal in the region, helping to put in place strong governance mechanisms for NTMs is the best donors can do to prevent their hijacking for protectionist purposes. In addition, open and inclusive regulatory governance mechanisms will contribute to anchoring "deep democracy" – the real participation of the private sector and civil society in key decisions affecting welfare and the day-to-day conduct of business. Last but not least, aiding the creation of effective regulatory supervisory agencies with similar agendas in the region will help to promote cooperation in NTMs around the Mediterranean, a type of technical-level cooperation that has proved in other regions to be a powerful vehicle for "substantial" integration – as opposed to high-level pronouncements – and for the reduction of trade frictions.

NTMs alter trade costs and market structure

NTMs are complex instruments, their impact on the economy being felt through multiple channels. They are primarily regulatory instruments targeted at particular market failures, but they affect the distribution of income in many ways through their impact on market structure, costs, and rents. Moreover, they generate cross-border externalities not only through the usual channels,[4] but also directly by segmenting markets.

NTMs are not necessarily border instruments *stricto sensu*. First, their primary objective may not be, and often is not, trade related. Technical and sanitary regulations usually have to do with public health, the protection of the environment, and other "local public goods". For instance, a regulation on the use of retreaded tires will affect imports of new tires, but this is probably not its primary objective. Second, NTMs should affect imported and domestic products equally unless they are deliberately designed in a discriminatory manner. For instance, a restriction on the use of toxic dyes in fabrics should affect equally imported and locally-produced fabrics.

However, like other trade policy instruments, NTMs create wedges between domestic and world prices. What distinguishes NTMs from other trade policy instruments is the mechanisms through which the wedge is generated and the corresponding rent-generating mechanisms. In the case of tariffs, the wedge is simply the tariff rate. In the case of NTMs, it is generated by the combination of several effects. First, NTMs generate direct compliance costs; for instance, eliminating toxic dyes in beach shoes (*espadrilles*) raises their cost by as much as 60%. Second, NTMs generate business costs by the sometimes heavy paperwork needed to prove compliance. For instance, respondents to a PAFTA survey reported devoting up to 60 man-days per year to paperwork and bureaucratic hassle. Provided that NTMs are administered in a non-discriminatory manner, neither of these two contributing factors to the wedge between domestic and world prices is appropriated by either domestic or foreign agents. In that sense, NTMs are "dissipative barriers" – they raise prices without leading to direct rent capture. However, and this is the third factor contributing to the wedge, NTMs may affect market structure and reinforce market power for the importing market.

4 See Staiger and Sykes (2009).

Indeed, one of the most important characteristics of NTMs is how their effects interact with market structure. Standards segment markets, as do quantitative restrictions, generating market power. In addition, it has been known since the work of Bhagwati (1968) that in the presence of domestic market power – a frequent occurrence in Mediterranean countries – quantitative restrictions are the worst type of instrument, raising prices while failing to encourage domestic producers to expand employment.

How these complex channels of influence combine to affect domestic prices is still imperfectly known empirically. What follows is a brief review of the evidence on the price-raising effect of NTMs in the region.

NTMs: What do we know?

Filling the transparency gap

Because NTMs are complex instruments, characterising them is a challenge in itself, and various analytical definition have been proposed in the literature (see, for example, Deardorff and Stern 1997). Compounding definitional issues is a huge transparency gap. NTM data has been collected by UNCTAD and published in the TRAINS database using WTO motofocations, but coverage was incomplete (see Carrère and de Melo for an analysis) and the exercise was carried out only once. Moreover, the voluntary nature of the WTO's notification to provide information on NTMs has prevented it from yielding anything like a comprehensive database (see Bacchetta et al. 2012). Private-sector perceptions have also been gathered through surveys of the private sector by the ITC (Mimouni et al. 2011).

In 2009, the UNCTAD-driven Multi-Agency Support Team (MAST) (including the ITC, the World Bank, USITC, the WTO, and the OECD, among others) initiated a major effort to revamp the NTM classification and the NTM database. MAST proposed a new classification better suited to the type of NTMs that have been spreading around the world. The new classification has then been updated and adopted in March 2012 by the WTO to make it suitable for notifications, yielding a unified classification system. The World Bank also collected official NTM data in 2010-11 by hiring local consultants (universities, think tanks or consulting firms) and giving them guidelines and assistance to obtain information from ministries and agencies involved in trade-relevant regulations. Inventories were formatted according to the new NTM classification, by product affected, together with information on legal sources and enforcing agency. Validation workshops were then held to ensure the data's integrity and to seek approval of national authorities. Finally, the data was forwarded to UNCTAD for technical checks and posting on WITS, the free online trade data portal[5].

Data was collected in Egypt, Lebanon, Morocco, Tunisia, Kenya, Mauritius, Tanzania, Uganda, Senegal, Namibia, Madagascar, South Africa, Cambodia, Lao PDR, and Bangladesh, in addition to the seven countries covered by the MAST pilot phase. Data was also collected, independently, by the EU, and a joint World Bank/AfDB project is financing data collection in China. Counting the 11 Latin American countries for which data collection was coordinated by ALADI in collaboration with UNCTAD, and Indonesia for which the government has been collecting and posting online NTM data, data coverage actually stands at 31 countries – still far from universal coverage, but nevertheless a marked acceleration since the pilot phase.[6] The World Bank is currently supporting data collection in South Asian countries and Kazakhstan.

NTM incidence in the region

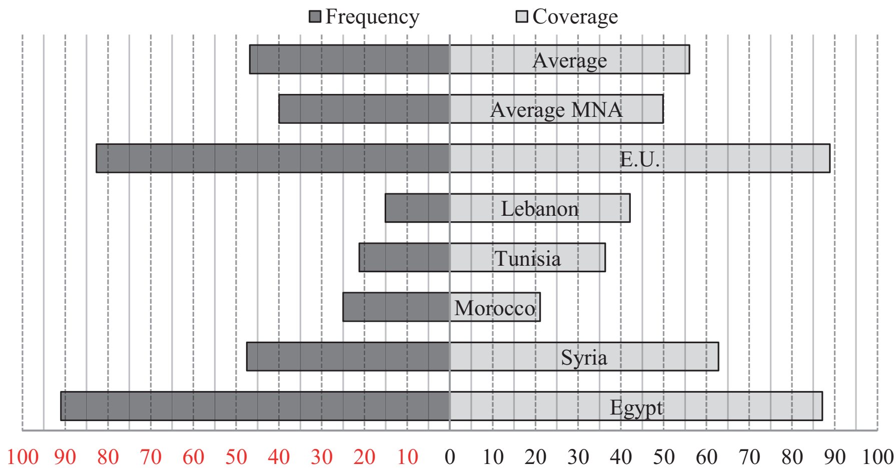
On the basis of the data available for five MENA countries, NTMs cover, on average, about 40% of the products imported by the region (from other countries within the region and the rest of the world) and 50% of the value of its imports. These frequency ratios are

5 wits.worldbank.org

6 The World Bank's data-collection effort was financed by a trust fund. As a follow-up to this and other data-collection initiatives, an ambitious multi-agency partnership, Transparency in Trade (TNT), has been set up in 2011 by the World Bank, UNCTAD, the ITC, the WTO and the African Development Bank (AfDB) to coordinate the collection and publication of trade data, including on NTMs. The TNT initiative is expected to give a "big push" to data collection with donor financing and to put in place a sustainable mechanism for NTM data collection.

quite similar to what is observed in other regions of the world, and significantly lower than those of the EU. Strikingly, they are substantially lower than the levels recorded in the TRAINS database for the year 2001, in particular concerning old-style command-and-control instruments (quantitative restrictions, prohibitions, or anti-competitive measures).[7]

Figure 1 NTM frequency and coverage ratios, selected countries



Note: Measures coded A to E in the MAST classification.

Source : World Bank/UNCTAD NTM data

A first pass at the data shows that the region does not stand out as an outlier compared to the average of 29 countries for which data is currently available (first horizontal bar in Figure 1) in terms of either NTM frequency ratio (dark grey) or coverage ratio (pale grey). By contrast, the EU stands out as a heavy user, an issue we will return to in Section 4.

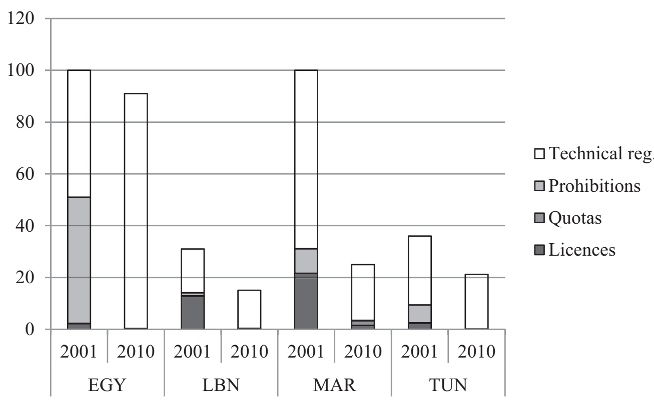
NTM frequency ratios (in dark grey) vary substantially across countries in the region, with the lowest rates for Lebanon (15%) and Tunisia (22%), followed by Morocco (25%). In terms of coverage ratio, Morocco stands as the least affected (21%), implying

7 Some import monopolies remain on products such as medications, cereals, oil and sugar in Tunisia, which are managed by Tunisia's *Direction Générale du Commerce Extérieur*. A number of tariff quotas are also imposed on food products.

that, compared to other countries in the region, Morocco tends to impose NTMs on relatively low-value items.

Figure 2 shows a very tentative comparison between core NTB frequency ratios shown in Table 1 of Kee et al. (2009) using TRAINS data for 2001 and frequency ratios observed in the 2010 data. Core NTBs, as defined by Kee et al., include price controls, quantitative restrictions, monopolistic measures, and technical regulations. We have tried to stay as close as possible to this using the MAST classification. The result is striking – frequency ratios are down in all countries for which both periods are documented; marginally in some cases like Egypt, or drastically in some like Morocco (Tunisia and Lebanon being in between these two extremes). This is interesting, as it suggests that some changes have been implemented over the last decades in terms of reducing the incidence of command-and-control instruments such as quantitative restrictions, prohibitions, and anti-competitive measures.

Figure 2 Fequency ratios, core NTBs, 2001-2010

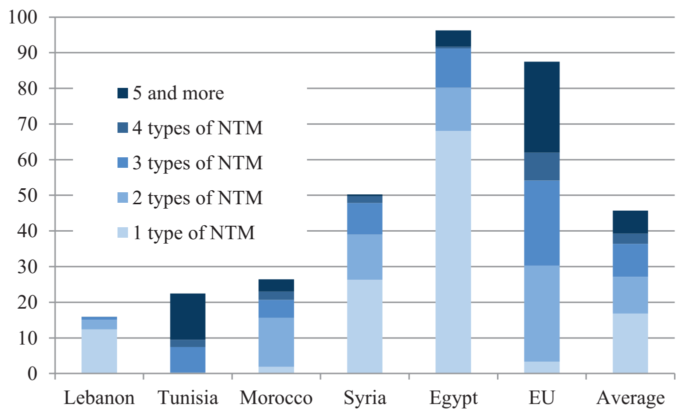


Source : World Bank/UNCTAD NTM data

The reduction would be even more marked if technical regulations (SPS and TBT) were not included, as the use of such measures has spread. As a matter of fact, technical regulations have replaced all other measures in the majority of cases. This raises an interesting question, which can be answered only through case studies on the ground. On one hand, this can be seen as a modernisation of the NTM apparatus in all MENA countries, marking a shift from protectionist measures (NTBs) to regulatory ones (NTMs). On the other hand, it could also hide the increasing use of technical regulations as barriers to trade, through complex design that ends up being discriminatory *de facto*, although not *de jure*.

Frequency and coverage ratios bunch together products covered by one measure and products covered by many ones. Figure 3 attempts to break this down by type of measure,[8] the assumption being that several measures of different types imposed on the same product may generate a particularly heavy compliance burden. Along that dimension, it can be seen that Tunisia stands out as a user of multiple measures, suggesting a possible lack of internal coordination between government administrations.

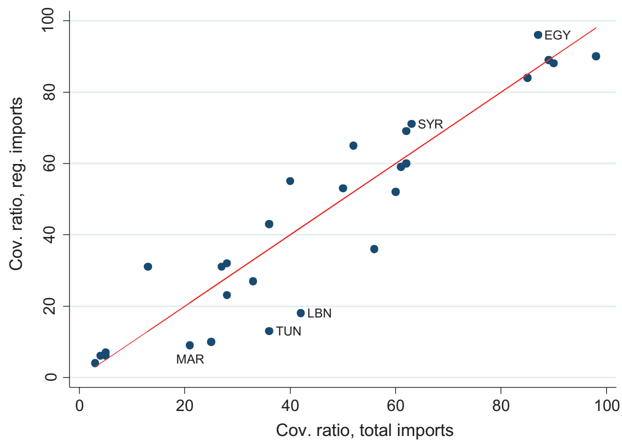
Figure 3 Average number of measures imposed by product



Note: Types of measures are defined by the MAST nomenclature at the one-letter, one-digit (e.g. A100) level.
Source : World Bank/UNCTAD NTM data

8 Types of measures are defined here at the 3-digit MAST classification level, i.e. A110, A120 etc., which is, for most measures, the finest level of classification.

Figure 4 NTM incidence, by type of trade (intra-regional vs. total trade)



Source : World Bank/UNCTAD NTM data

Most of the region's NTMs are applied on a non-discriminatory basis and there is no evidence that they affect regional trade by design. They might still affect it de facto if their incidence was borne disproportionately by products accounting for a large part of intra-regional trade. Figure 4 verifies this conjecture by plotting NTM coverage ratios in terms of total imports (horizontal axis) versus intra-regional imports (vertical axis) for all countries with data worldwide, with regions being defined by the World Bank's categories. Points above the 45o line mark NTM structures falling disproportionately on intra-regional imports, and vice versa. It can be seen that Egypt and Syria – whose data must be interpreted very cautiously – are the only two countries within MNA with NTM structures penalising regional trade. Morocco, Tunisia and Lebanon are outliers in the other direction, with NTM structures penalising out-of-region imports. These results may also reflect the marginal share of regional trade for Morocco and Tunisia compared to Egypt and Syria.

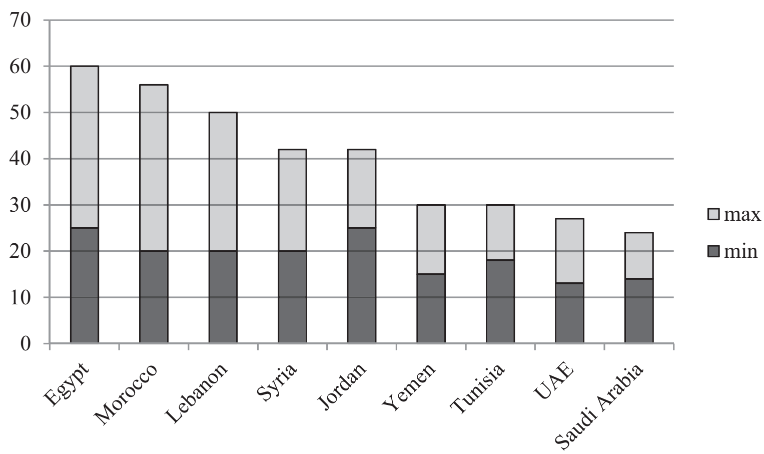
Cost-raising effect of NTMs: Private-sector perceptions

Private-sector perceptions of NTMs in the MENA region, based on a 2008 survey (Hoekman and Zarrouk 2009) suggest that the picture in terms of trade costs and NTMs has substantially improved (compared to a prior survey conducted in 2001), but that

Morocco and Tunisia still have relatively stringent trade regulations. Respondents' estimates of trade costs in the region are moderate: 6% on average, 7% in Morocco, and 11% in Egypt. Given the overall focus of the survey on trade facilitation, these estimates are likely to reflect direct compliance costs rather than the total price increase due to changes in market structure, sourcing mix, and product mix that ad-valorem equivalents (AVEs) pick up.

Technical regulations, in particular relating to packaging and labeling, were perceived to be problematic in foodstuff trade, in particular when importing into Egypt, Syria and Lebanon. Testing and certification requirements were also considered haphazard. However, only 30% of the respondents considered technical regulations to be a major hurdle to trade in the region. Most of the problems came from enforcement on the ground, including border inspections.

Figure 5 Man-days spent per year resolving problems with customs and tax administrations



Source: Adapted from Hoekman and Zarrouk, Table A-6.

In general, red tape is a recurrent complaint in the region. Figure 5 shows the time spent dealing with bureaucratic issues, by country. Tunisia is now in the lower tail of the distribution, but Egypt and Morocco are, again, among the worst performers, although, again, the figures reported by respondents are not outrageous. Almost two-thirds of the companies surveyed have more than 50 employees, so spending, on average, 30 man-days per year dealing with administrative issues (Morocco) or 25 (Tunisia) may not be a first-order impediment to business (for a firm with 100 employees, we are talking about one-sixth of 1% of total man-hours). Again, however, this is only a direct measure of the cost involved in fixing day-to-day problems and is likely to overlook the deeper problems stemming from induced changes in sourcing and import costs.

All in all, private-sector operators signaled concerns not just about the measures themselves, but also about their enforcement on the ground, calling for effort aimed at improving both regulatory design and border-management procedures.

Price effects

The effect of NTMs on domestic prices can be estimated using a methodology called "differences in differences" (DID) that uses the price of products affected by NTMs in some countries as "treated", and using the prices of similar products in countries not applying the NTMs as "controls". Fixed-effect panel estimation techniques are used to control for systematic cost of living differences across countries and for heterogeneity of products.[9]

The sample used for the estimation combines price data from the World Bank's International Price Comparison Project (IPCP) that contains domestic prices in local currency units (LCU) for 66 products, as well as a number of services that we don't use. After converting domestic LCU prices into dollars at current exchange rates, we combined them with NTM data from the World Bank/UNCTAD database aggregated up from HS6 into the IPCP's product categories.[10]

The estimation equation is given in Appendix A. Estimates suggest that the wedge introduced by NTMs between domestic and world prices is typically large in Morocco

9 That is, estimation uses a full set of country and product dummies, in addition to controls for tariffs at the country-product level. IV estimation to control for NTM endogeneity yields weak results.
10 After aggregation, NTM data takes the form of coverage ratios.

and substantial, albeit lower, in Tunisia. SPS measures are responsible for a good chunk of the AVEs in Morocco, whereas other technical regulations are more important in Tunisia. Results are displayed by country in Tables A1 for Morocco and A2 for Tunisia. They should be interpreted with caution, given that they are obtained by aggregating NTM coverage ratios up to the fairly broad level of ICP products, resulting in a loss of precision. They may also suffer from endogeneity bias, although the use of country and product effects controls for many possible omitted variables.

With all appropriate caveats, the results suggest high AVEs in Morocco, in particular in comparison to Tunisia. In Morocco, total AVEs range from zero to over 373% (rice), with the bulk of the effect generated by SPS measures (category A).[11] This is to be expected given that the ICP database oversamples food products. In Tunisia, AVEs range from zero to 105.2% (lamb meat),[12] with only technical regulations (category B) and price-control measures (category D) showing up as statistically significant. Simple averages across products in the ICP database (which are not representative of the average household consumption basket, as ICP products are chosen for their international comparability) are 62.6% for Morocco and 13.4% for Tunisia. Once zero-AVE products are taken out, simple averages rise to 87.6% and 37.4% respectively. That is, in Tunisia, relatively few products are affected by NTMs, but for those products the implied price wedge is substantial, although much less so than in Morocco.

11 The case of rice is particular. In September 2007, Morocco's rice producers requested the adoption of "safeguard measures on rice originating from Egypt", an awkward request since safeguard measures, unlike anti-dumping, must be applied on an MFN basis rather than on a bilateral one. The Ministry of Foreign trade rejected the request in November 2008 and instead put in place a surveillance system. The market outlook changed substantially since then: In April 2011, Morocco's Foreign Trade Minister Abdellatif Maazouz called during a visit to India for enhanced exports of Indian rice to Morocco (India currently enforces an export ban on non-basmati rice). See http://post.jagran.com/morocco-seeks-rice-wheat-supply-from-india-1303995783. In the econometric estimation, the 374.7% AVE is obtained by compounding a 112.3% AVE for SPS measures (cat. A) and a 123.6% AVE for price-control measures (cat. D).

12 This is the second-highest AVE. The maximum value is 128.1% for pork meat, a special case for obvious reasons. Meat imports are marginal in Tunisia, which has a strong domestic cattle production making it almost self-sufficient.

From regulatory incoherence to policy deadlock

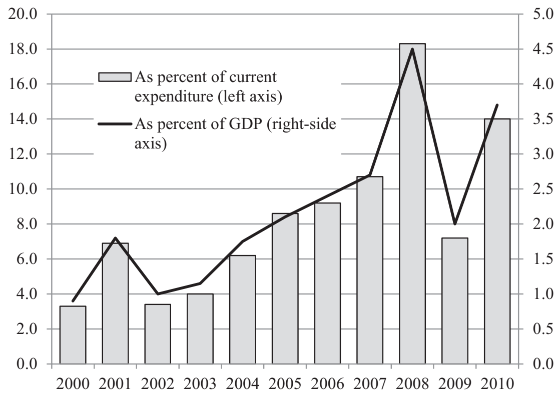
In MENA countries, NTM and regulatory frameworks have largely grown in ad hoc fashion in response to various pressures, including harmonisation with the EU's *acquis communautaire* as part of FTAs for some, lobbying pressures, public safety concerns, or bureaucratic incentives to create turf for themselves. In that, MENA countries do not differ fundamentally from others, as competence over NTMs is everywhere fragmented over a large number of loosely coordinated ministries and agencies with different, and not necessarily compatible, policy mandates.

The need for a more coherent and coordinated policy environment is particularly acute where there are inconsistent regulatory architectures, with measures working at cross-purposes and resulting in policy deadlock with serious implications for overall competitiveness. The problem is illustrated by the case of Morocco, which also highlights how high the stakes can be when regulatory incoherence may lead to policy deadlock.

While imposing price-raising NTMs, Morocco's government simultaneously – albeit without a specific "compensatory" design – tries to contain the cost of living with the help of fuel and other subsidies. These subsidies are likely to be regressive, as fuel consumption is a superior good in countries with mild climates (for instance, car ownership and air-conditioning, two large sources of fuel expenditure at the household level, are associated with relatively affluent living standards).

In addition, Figure 6 shows that their cost has been spiraling out of control since 2002, with only a brief respite during the global financial crisis. Thus, these subsidies (i) impair the government's ability to direct scarce budgetary resources toward competitiveness-enhancing uses; and (ii) constitute a large contingent liability, as any rise in the exchange rate could trigger a budget crisis given the current structure of the subsidy system. In this context, the government and the private sector have been debating any space for exchange-rate adjustment to encourage the economy's diversification. Budgetary constraints have also limited the scope to redirect resources toward job-creating, export-oriented sectors through either government investment to alleviate supply-side bottlenecks.

Figure 6 The cost of fuel and other subsidies, 2000-2010



Source: Central Bank.

The potential cost of this toxic policy mix in terms of job growth, competitiveness and even social stability may well prove, in the long run, very high.

Tackling NTMs: The way forward

The analysis above suggests that NTMs constitute a pregnant issue that goes well beyond the reduction of trade costs. What is needed is a move towards coherent and compatible regulatory structures with countries and across the region, with the overarching goal of fostering competition at home and competitiveness abroad. The next question is how to get there. This section will argue that a top-down technocratic approach may not be the best. In the region's post-Arab Spring, emerging democracy context, the priority in policy dialogue should be to encourage the emergence of effective, open governance structures endowed with policy analysis capabilities.

Harmonisation of standards: A flexible approach

Harmonisation with EU standards can help MENA countries to reduce quality uncertainty, improving market access, and to make domestic markets stronger breeding grounds for potential exporters. However, these benefits may come at a price. Disdier et al. (2012) argue that by adopting stiff Northern standards as part of free-trade agreements (FTAs), Southern countries may end up raising the costs of their domestic producers and pricing them out of other Southern markets where such stiff standards confer no competitive advantage. They show, on the basis of a gravity equation, that this effect is statistically traceable in trade flows and reinforces the hub-and-spoke structure of international trade flows, with spokes (the Southern partners of North-South FTAs) less able to "trade out" with other Southern countries out of their bloc.

Some EU FTAs with MNA countries explicitly provide for alignment of partner-country regulatory system on the "*acquis communautaire*". For instance, Article 51 of the EC-Morocco FTAs states that:

> "[t]he Parties shall cooperate in developing: (a) the use of Community rules in standardisation, metrology, quality control and conformity assessment; (b) the updating of Moroccan labouratories, leading eventually to the conclusion of mutual recognition agreements for conformity assessment; (c) the bodies responsible for intellectual, industrial and commercial property and for standardisation and quality in Morocco."

Article 51 of the EC-Tunisia FTA is identical. Article 40 of the EC-PLO FTA contains a harmonisation clause worded in similar language: "The objective of cooperation will be to narrow the gap in standards and certification. In practical terms cooperation will take the form of the promotion of the use of Community technical regulations and European standards and conformity assessment procedures". Likewise, Article 68 of the EC-Jordan agreement states that "[c]ooperation in this field will be aimed in particular at: (a) increasing the application of Community rules in the field of standardization, metrology, quality standards, and recognition of conformity". In such cases, it seems to be the intention of EU negotiators to encourage partners to adopt EC regulations even for products aimed at the domestic or other, non-EU export markets.

The EC-Egypt agreement contains no suggestion of that type. Instead, harmonisation is expected to take place on the basis of international standards. Nonetheless, the Egyptian Organization for Standardization and Quality (EOS) claimed in 2008 that it had completed the harmonisation of over 80% of its technical regulations with those of the EU, and in January 2008 EOS became an affiliate member of CEN, the European standards body (Ghoneim 2009).

In view of the dynamism of Southern markets, especially in comparison with those of the Eurozone, RPMCs may want to approach the issue of harmonisation in a flexible way, modulating the speed of convergence on the basis of export potential. For sectors whose primary export potential is in EU markets, fast harmonisation may be optimal; for sectors whose primary export potential is in the South, slow harmonisation may be better.

Piecemeal reform efforts

MENA countries have put in place a number of dialogue structures to improve the regulatory environment and broader aspects of the business climate. However, the ostensible objective of these structures is often to improve ratings in the World Bank's *Doing Business* index rather than to yield genuine results.

For instance, in 2009 Morocco created the CNEA (*Commission Nationale de l'Environnement des Affaires*) in order to put in place the "National pact for industrial emergence", but also to look for ways of improving poor *Doing Business* ratings. The CNCE (*Conseil National du Commerce Extérieur*) was also conceived as a public-private dialogue structure, but the private sector's participation has been dwindling, with the *Conseil* recently transformed into an Observatory. Other structures exist, and similar ones have been created with similar objectives in other Mediterranean countries. The common points of all these structures are that: (i) they are not supported by a strong culture of multi-stakeholder dialogue, and the private sector appears less than fully convinced of the benefits of participating actively; (ii) they tend to have little decision-making power and political traction; and (iii) they do not have autonomous policy analysis capabilities and have not had the time or the opportunity to gather clout. Thus, without a strong push, they are in in a weak position to advance an agenda of genuine reform or even to make a difference in the overall coherence of regulatory structures.

Toward regulatory governance

The brief factual analysis presented in this chapter suggests a policy diagnosis along the following lines:

1. In resource-poor Mediterranean countries, NTMs contribute to segmenting markets and to raising the domestic prices of affected products, generating countervailing demands for other distortionary policies to contain the cost of living. The combination of these distortionary measures generates inefficiency and policy deadlock.
2. Significant progress has been made and is reflected in private-sector perceptions, but reforms have remained superficial – from the adoption of technical improvements in border management without a change of enforcement culture, to the creation of dialogue structures that remain largely empty shells for lack of political drive.

Notwithstanding the difficulties encountered in past reform efforts in MNA countries, the authors of this note believe that now is the time to build and support a reform agenda around the notion of regulatory governance.

Streamlining NTMs in the region should not be thought of as a search for quick wins to reduce trade costs by a few percentage points, because the factual analysis presented in this chapter suggests that, with some exceptions, the stakes on that front alone may not be that high. Instead, streamlining NTMs should be viewed in a more ambitious way, as an entry door to a wide-ranging regulatory improvement agenda whose real aim is to place good governance and dialogue practices at the heart of government action. In the context of a newly established democracy, such an agenda – in the area of regulatory governance as in other ones – is key to ensuring that the democratic process does not remain confined to shallow electioneering, but instead goes deep into government action.

Putting in place good governance structures to manage NTMs can be based on blueprints that have been tried elsewhere, essentially based on the concept of a "regulatory impact assessment" (RIA). Two types of challenge are involved. The first is institutional – to get different agencies to coordinate around a complex process based on transparency and economic rationality. The second is analytical – an RIA is a difficult exercise requiring capabilities that are unlikely to be readily available in MNA administrations. The "RIA industry" (a galaxy of consulting firms, international organisations and donors advising governments on RIA) has approached the capability issue by watering down the analytics to the point where administrations are only expected to check lists of boxes, sometimes resulting in exercises that are, by the industry's own recognition, largely useless.

There is a way out of this conundrum. In both cases (ex-post review and ex-ante RIA), what is needed is a strong, full-hearted training and capacity-building effort. The World Bank has recently issued an NTM streamlining toolkit (Cadot et al. 2012) predicated on the notion that precise, targeted technical assistance can make meaningful NTM analysis possible even when capabilities are initially low. The World Bank's approach is meant to ensure that the regulatory review process, whether *ex ante* or *ex post*, does not produce, out of a desire to keep things simple and quick, systematically biased results focused exclusively on the reduction of business costs at the expense of local public goods.

A road map toward regulatory governance

The considerations above suggest a clear agenda for action, with donor support. In the short run, RPMCs should:

- Put in place structures to monitor NTMs and update, publish and analyze data.
- Use these structures as forums for permanent dialogue with the private sector on a broad set of competitiveness-related issues, including NTMs and "doing business", and consolidate existing initiatives in this area running in parallel.
- Generate immediate momentum for reform by identifying "low-hanging fruit" – regulatory changes that can rapidly generate visible gains, including simplifications and "guillotine" reductions in regulatory text; *but they should not stop there*.

In the medium run, they should:

- Endow these structures with clearly defined mandates, budget resources and analytical capabilities to conduct reviews of existing and new NTMs, possibly in collaboration with universities and think tanks.
- Put in place arbitrage structures to make binding decisions on regulatory changes in conformity with the results of analytical assessments.

Encouraging the emergence of solid regulatory oversight bodies in the region may also be an effective way of fostering regional integration. International experience in other regions suggests that informal cooperation at the technical level can be a powerful vehicle to foster substantial integration. In ASEAN, for instance, anecdotal evidence suggests that many problems get solved at the technical level through informal phone calls before they have a chance to ratchet up to the political level where trade-offs become complex. Such informal cooperation is facilitated if technical personnel in the region's regulatory oversight bodies shares a common vision, acquired for example during common training.

In the long run, regulatory oversight functions should be merged with competition policy functions into single agencies. There are several arguments in favour of such a combination. First, as argued earlier in this chapter, regulation and market structure are deeply interlinked and should be considered at the same time. Second, the type of competencies required for regulatory and anti-trust oversight – law and industrial economics – are largely the same. Third, and perhaps most importantly, the experience of other countries that have embarked upon regulatory reforms, like Mexico, suggests that competition authorities easily gather more clout than regulatory oversight bodies, which can fall victim to shifting political winds (see, for example, Haddou 2012). Putting the two in the same house would anchor the regulatory oversight function, shelter it from political interference, and give rise to a powerful watchdog body for both the private and the public sectors, adding to its legitimacy.

Concluding remarks

Given the intensity of price competition in the textile and apparel sector, it is not certain that the existing strengths of RPMCs in this sector can translate into substantial job creation in the future. Whether export-led diversification of export structures can be sufficiently vigorous to generate the employment growth needed to absorb new labour force entrants is also an open question. Should a strong export drive materialise upon the adoption of adequate macroeconomic and trade-facilitation policies, much would depend on the ability of RPMCs to develop labour-intensive backward linkages in intermediates production and business-support services.

That is where the quality of the regulatory environment can make a difference, by encouraging inward investment and facilitating the growth of local entrepreneurship. The message of this chapter is that in order to develop an effective regulatory framework, one needs to put in place solid and credible regulatory governance structures based on the right mixture of participation and "technocratic" capabilities.

Donors can help in this effort, and ensure that it progresses in parallel across the region, by providing strategic guidance on the adoption of regulatory best practices and, most importantly, through a long-term capacity-building effort at all levels of the relevant administrations.

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Appendix

Our estimation strategy is a simple treatment-effect approach where prices are "treated" by NTMs. The corresponding difference-in-difference (DID) equation is

$$\ln\left(a_{ik}\right) = \alpha_0 + \alpha_1 \ln\left(1+t_{ik}\right) + \sum\nolimits_{j=A}^{E} \beta_j c_{ijk} + \sum\nolimits_{i\in \text{MNA}} \sum\nolimits_{j=A}^{E} \gamma_j \left(c_{ijk} \times \delta_i\right) + \delta_i + \delta_k + u_{ik} \tag{1}$$

where ln (a_{ik}) is the log of the price gap observed between country i and the average of all 30 countries in the sample for product k; ln $(1 + t_{ik})$ is the log of one plus the tariff, in ad-valorem form, imposed by country i on product k; c_{ijk} is the coverage ratio, in country i, of NTM type j ($j = A$-E using the MAST nomenclature) on product k, δ_i is a country fixed effect, and δ_k is a product fixed effect. Product effects control for market-structure differences across products which could account for systematic differences in the cross-country dispersion of prices. Country effects control for systematic cost-of-living differences across countries. The data consists of 1,260 product-country pairs treated as a panel.

AVE can be retrieved algebraically as follows. Suppose that there is only one NTM, of type A, and that $c_{ijk} = 1$. Then

$$\ln\left(\hat{a}_{ik}\right)\Big|_{c_{iAk=1}} = \hat{\alpha}_0 + \hat{\alpha}_1 \ln\left(1+t_{ik}\right) + \hat{\beta}_A + \hat{\gamma}_A I_i + \delta_i + \delta_k \tag{2}$$

Suppose now that $c_{ijk} = 0$. Then

$$\ln\left(\hat{a}_{ik}\right)\Big|_{c_{iAk=0}} = \hat{\alpha}_0 + \hat{\alpha}_1 \ln\left(1+t_{ik}\right) + \delta_i + \delta_k. \tag{3}$$

It follows that

$$\ln\left(\hat{a}_{ik}\right)\Big|_{c_{iAk=1}} - \ln\left(\hat{a}_{ik}\right)\Big|_{c_{iAk=0}} = \ln\left(\frac{\hat{a}_{ik}\big|_{c_{iAk=1}}}{\hat{a}_{ik}\big|_{c_{iAk=0}}}\right) = \hat{\beta}_A + \hat{\gamma}_A I_i \tag{4}$$

So

$$\frac{\hat{a}_{ik}\big|_{c_{iAk=1}}}{\hat{a}_{ik}\big|_{c_{iAk=0}}} = e^{\hat{\beta}_A + \hat{\gamma}_A I_i} \tag{5}$$

or

$$\frac{\Delta \hat{a}_{ik}}{\hat{a}_{ik}\big|_{c_{iAk}=0}} = e^{\hat{\beta}_A + \hat{\gamma}_A I_i} - 1 \tag{6}$$

Note that this formula differs from the one seen in the context of quantity-based estimation because we are dealing here directly with prices, rather than inferring AVEs from quantity adjustments.

Expression (6) gives the rise in the price of good *k* generated by a coverage ratio going from zero to one, as would be the case if NTMs were applied to products at the level at which the estimation is carried out. However, our unit of observation is an ICP product, which is an aggregate of HS6 products. As a result, our coverage ratios are in between zero and one, and AVEs must be "deflated" to take that into account. Thus, if aggregate product *k* (defined using the ICP nomenclature) is covered by NTM type *A* with a coverage ratio of c_{ik}, we set its AVE at

$$\frac{\Delta \hat{a}_{ik}}{\hat{a}_{ik}\big|_{c_{iAk}=0}} = c_{ik}\left(e^{\hat{\beta}_A + \hat{\gamma}_A I_i} - 1\right). \tag{7}$$

7 Assessing MENA's trade agreements

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1. Introduction

In May 2011, President Obama compared aggregate non-oil exports of the Middle East and North Africa (MENA) region – a region of over 400 million people – to Switzerland.[2] The remarks were made to highlight the lack of economic integration in the region in a speech outlining the US response to the Arab Spring. To promote integration, a key pillar of his plan is the launch of a "comprehensive Trade and Investment Partnership Initiative in the Middle East and North Africa." The EU similarly promised to strengthen its neighborhood policy that links it with North Africa and the Levant. Both the US and the EU have argued repeatedly that deeper trade integration with the region is important, as it will promote economic growth and job creation. The Deauville Partnership grew out of this belief, with governments in the G8, the Gulf states and Turkey promising more openness to the countries in various stages of transition (Egypt, Jordan, Libya, Morocco, and Tunisia) as they reform their political and economic systems. The initiative is aimed at spurring trade and foreign investment, as the industrial countries promise more market access for manufactures and agriculture, help foster regulatory convergence and enable services trade. In turn, the partnership countries are asked to improve governance remove restrictions on trade and FDI, and improve trade facilitation.

1 We are grateful to Milagros Deza for excellent research assistance.
2 The transcription of President Obama's May 2011 speech can be found at http://www.guardian.co.uk/world/2011/may/19/barack-obama-speech-middle-east

Underdeveloped trade integration in the MENA region is well known. Outside of natural resources, the region has failed to globalise alongside the rest of the world. Recent work shows that MENA under-traded by about 60-70% in the 2000s, compared with its potential (Behar and Freund 2011). Intraregional trade is just 10% in MENA as compared with one-quarter for ASEAN and two-thirds for the EU. Diversification has been limited in the region, especially among oil exporters, with two-thirds of countries displaying concentration significantly above predicted levels given income (Diop et al. 2012).

Recognition of the relatively low level of integration and economic diversification dates back decades and efforts to spur trade are not new. Countries in the MENA region have formed preferential trade agreements among themselves and with the EU, US, and Turkey to stimulate trade. All of the countries in the region, with the exception of Iran, are currently members of at least one intraregional agreement and a number of countries have also signed agreements with the EU and the US.

In this chapter, we assess the trade effects of these agreements, and compare them to membership in the EU, the gold standard of regional trade agreements. The purpose is to determine whether this policy of trade agreements to stimulate integration has been successful.

Using data from 1994-2009, we estimate a panel gravity model that controls for country-pair fixed effects, as well as importer-year and exporter-year fixed effects. The advantage of this model is that it considers the effect of the agreement on trade following implementation, controlling for bilateral trade patterns and changes in country-level export and import patterns that affect all trade partners, such as income growth, lower tariffs, or improved trade facilitation. It does not merely compare trade with the agreement to predicted trade from standard variables. The disadvantage is that we can only estimate effects of agreements that entered into force over this period.

The results point to small effects from GAFTA, EU-MENA and Turkey-MENA agreements, which are less than standard PTAs. In contrast, effects from AGADIR and US-MENA have been at or above standard PTAs.

These overall results, however, obscure important differences between export and import effects and across countries. In particular, disaggregating the effects, we find that agreements with the EU have served EU exporters, with no evidence of a positive and significant effect on MENA's exports. In contrast, the additional success of agreements with the US is limited to the US-Jordan agreement. Only AGADIR has had broader effects, similar to those of a standard PTA. We also estimate effects excluding oil and other natural resources, and results remain largely unchanged.

The bottom line is that current trade agreements have not stimulated trade in an economically meaningful way. Going forward, this means that US and EU trade agreements must be done differently from past accords with the MENA countries, if they are intended to have a positive development effect on the region. In particular, more in-depth agreements combined with domestic reforms would be required to have a transformational effect. Put differently, more of the same will accomplish little.

The remainder of the chapter is organised as follows. The next section reports summary statistics on trade patterns in the region and trend in regional trade. Section 3 reports results from the gravity estimation. Finally, Section 4 concludes.

2. Data, summary statistics and trends

One way of examining the effects of PTAs is simply to look at how exports and imports evolve over time. This section discusses the trade used and shows the evolution of trade in the MENA region with various groups, and in greater detail, before and after each PTA. Annex A details membership of all agreements focused in this research.[3]

Data for bilateral trade flows are compiled from COMTRADE. The data cover 150 countries, including almost all (World Bank defined) MENA countries for which data is available over the period 1994-2009. We proxy non-petroleum imports as the difference between total imports minus products under SITC code 33. We also produce a measure of non-natural-resource imports, which excludes various categories following the example of the WTO (2010) report on trade in natural resources. More precisely, the WTO (2010) defines natural resource imports as to encompass: fisheries (SITC 03), forestry (SITC 21,23,24,25,26,29), fuels (SITC 3), ores (SITC 27,28), and nonferrous (SITC 68).

Real GDP and real per capita GDP (at PPP) series are compiled from WDI. Data on preferential trade agreements are collected from CEPII, refined for MENA countries and completed for recent years. Appendix A details information on PTAs that include MENA countries used to construct the PTA dummies entering into our analysis. Table 1 reports summary statistics of variables appearing in regressions, including total imports, non-oil imports, and non-natural-resources imports used as explained variables as discussed below.

3 In the analysis, we exclude Israel from MENA aggregates and MENA PTAs, as only the Palestine Authority is a member of MENA PTAs but disaggregated trade statistics are unavailable. To be consistent, in the analysis, we do not treat the US-Israel FTA as a MENA PTA. The remaining MENA countries are: Algeria, Bahrain, Djibouti, Egypt, Iraq, Iran, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, and Yemen.

Table 1 Summary statistics

Variable	Obs	Mean	Std. Dev	Min	Max
ln(tot_imports)	230453	14.785	4.013	0	26.599
ln(non_oil_imports)	229859	14.664	3.962	0	26.597
ln(non_nat_res_imports	230453	14.769	3.990	0	26.577
PTA	376992	0.043	0.204	0	1
EU	376992	0.012	0.109	0	1
US_MENA	376992	0.000	0.013	0	1
EU_MENA	376992	0.005	0.073	0	1
TURKEY_MENA	376992	0.000	0.009	0	1
GAFTA	376992	0.008	0.087	0	1
AGADIR	376992	0.000	0.010	0	1
PRE_EU_PTA	376992	0.007	0.082	0	1

Next, we report, for each agreement, import and export volumes of MENA members over time, with year trade agreements entering into effect in year 1.

Figures 1-6 show that most agreements are associated with increasing trade. What is less clear is a distinct structural break around the time of the trade agreement, perhaps with the exception of US-MENA, Turkey-MENA and GAFTA. In the case of GAFTA, we see this pattern across all of the member countries. However, in the case of US-MENA, it is largely driven by the US-Jordan agreement. Figure 2 shows MENA exports to the US excluding Jordan, and Jordan's exports to the US. It is clear that much of the jump is driven by this special relationship. The surge in Jordanian exports to the US started before the entry into force of the US-Jordan PTA (in 2001) and coincides with the implementation of the so-called Qualifying Industrial Zones (QIZ) that started to operate in Jordan in 1998.[4]

4 Signed between Jordan and the US, Qualifying Industrial Zones (QIZ) extended the market access privileges of the US-Israel FTA to approved enclaves in Jordan producing goods in collaboration with manufacturers in Israel. To be eligible for free access to the US market, goods produced in QIZs have to comply with rules or origin specifying that at least 12 % of their value must be added by Jordanian manufacturer in the QIZ, 8% by an Israeli manufacturer, 15% can come from QIZ Jordan, Israel, West Bank/Gaza, or the US; and the remaining 65% can be from anywhere in the world.

Figure 1 US-MENA preferential trade

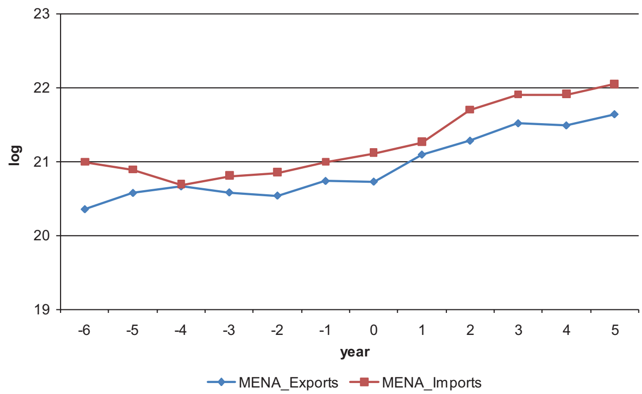


Figure 2 Jordanian exports to the US

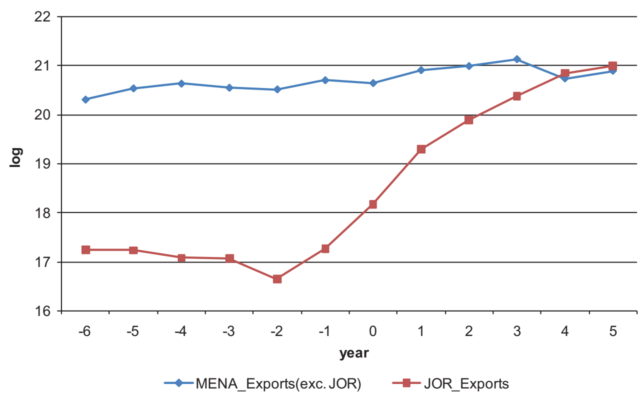


Figure 3 EU-MENA preferential trade

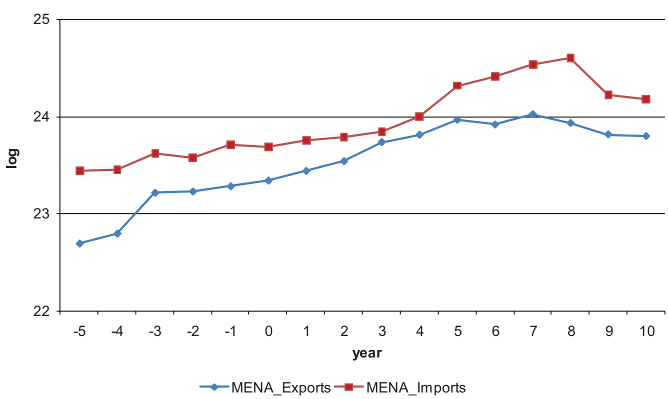


Figure 4 Turkey-MENA preferential trade

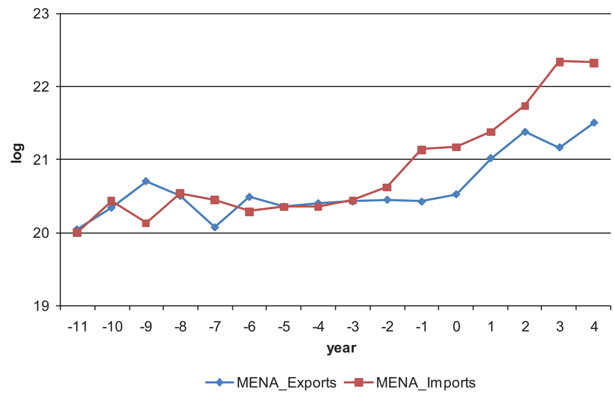


Figure 5 Trade among AGADIR members

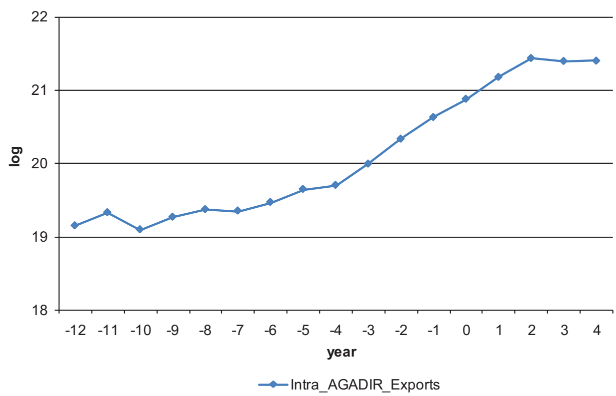
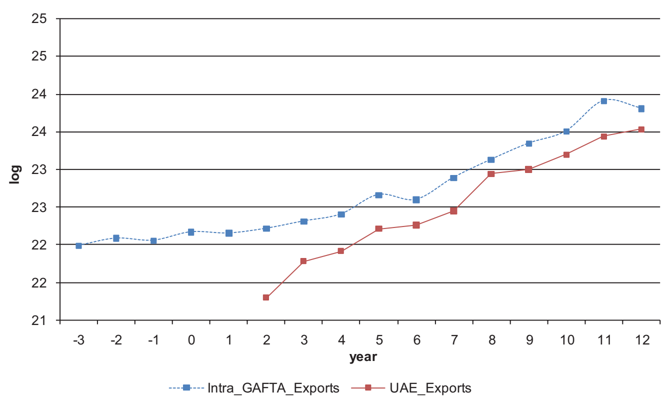


Figure 6 Trade among GAFTA members



In Figures 7 and 8, we examine MENA's trade with both trade-agreement partners and outsiders. Of special interest, trade with the rest of the world expanded as fast – if not faster – than with trade-agreement members. This suggests that the impact of the trade agreements was limited. Figure 9 focuses on the evolution of MENA's non-oil exports and confirms this trend.

Figure 7 MENA's total exports to different blocs

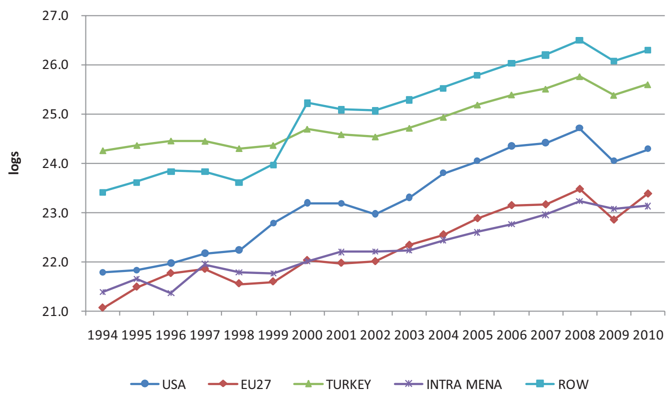


Figure 8 MENA's total imports from different blocs

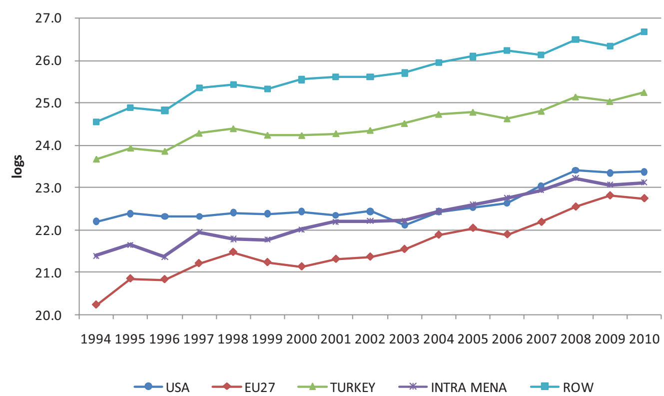
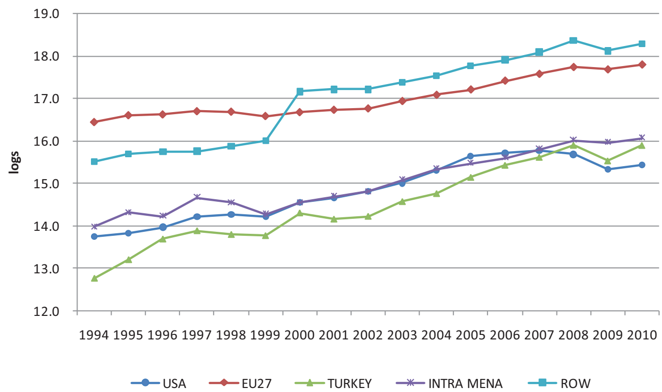


Figure 9 MENA's non-oil exports to different blocs



These trends provide an indication that the trade agreements may have boosted trade among signatories, but given the overall increase in trade over the period, the magnitudes are not particularly striking. In addition, this analysis does not control for other factors, such as income growth and trade openness. In the next section, we perform a regression analysis to estimate the impact of the trade agreements on trade.

3. Model specification and data

This section describes our estimation strategy. We use a panel estimation because cross-section regressions return biased estimates of trade costs variables. Baldwin and Taglioni (2007) show that panel estimates are superior to cross-section estimates for estimating the effects of trade costs variables, such as trade agreements, because the potential omitted variable bias is large in cross-section regressions, which leave out market potential variables. Indeed, we find that results from cross-section estimation are highly unstable. We use country-pair fixed effects to control for country characteristics and bilateral market potential. We also include importer-year and exporter-year fixed effects to control for country-level changes in trade that affect all trade partners, for example because of growth, changes in tariffs, or improved trade facilitation. This specification also removes concerns over multilateral resistance in standard gravity estimations since country-year fixed effects control for relative openness at each point in time. The disadvantage of this strategy is that we can only estimate effects of agreements that came into place over the period. In particular, we cannot assess other intra-MENA PTAs that entered into force before 1994, such as Gulf Cooperation Council (GCC) and the Arab Maghreb Union (AMU) in force since 1981 and 1989, respectively.

Model

We estimate the following gravity specification:

$$lnX_{ijt} = \beta_1 PTA_{ijt} + \beta_2 EU_{ijt} + \beta_3 ln(PRE\_EU\_PTA_{ijt})$$
$$+\beta_4(US\_MENA_{ijt}) + \beta_5(EU\_MENA_{ijt}) + \beta_6(TUR\_MENA_{ijt}) + \beta_7(IntraMENA_{ijt}) + \delta_{ij}$$
$$+ \delta_{it} + \delta_{jt} + \varepsilon_{ij}$$

where: lnX_{ijt} are imports of country j from country i in year t; PTA_{ijt} is a dummy variable assuming the value 1 if i and j have a preferential trade agreement in effect in year t and having entered into force after 1994,[5] and 0 otherwise; EU_{ijt} is a dummy equal to one when countries i and j are members of the EU in year t and zero otherwise; $PRE\_EU\_PTA_{ijt}$ is a dummy taking the value 1 if i or j are an EU member and an EU candidate having a PTA in effect in year t and 0 otherwise, which is used to assess the trade effects of PTAs between the EU and countries in accession prior to full EU membership. *US_MENA*, *EU_MENA*, and *TUR_MENA* are dummies characterising PTAs in which either i or j is a MENA country having a PTA with the US, EU or Turkey, respectively; $IntraMENA_{ijt}$ is a vector of dummies taking the value of 1 if i and j are two MENA countries having a PTA in effect in year t and 0 otherwise; δ_{ij} are exporter-importer country-pair fixed effects, δ_{it} and δ_{jt} are exporter-year and importer-year fixed effects, respectively. Country-pair fixed effects control for invariant

5 As our data covers the period 1994-2009 and we include exporter-importer country-pair fixed effects, we only code new PTAs, i.e PTAs having entered into force after 1994, so that this variable is comparable to the MENA PTA variable for other agreements.

characteristics specific to the country-pair such as distance, common language, common border, common coloniser, etc.[6] Importer-year fixed effects control for characteristics specific to the importer that evolve every year, such as tariff and non-tariff barriers, GDP, population, exchange rate, etc. Likewise, exporter-year fixed effects control for exporter's characteristics varying every year such as GDP, infrastructure, business environment, exchange rate, etc.

Notice that we coded PTA_{ijt} so that it also includes all other agreements that have a specific-PTA dummy variable, such as *US_MENA, EU_MENA, EU, PRE_EU_PTA*, etc. Therefore, the total trade effect of a specific-PTA would be the cumulative effect of the average PTA (estimated by β_1), and the specific-PTA effect (e.g. β_4 in the case of US-MENA PTAs). The coefficient on each MENA agreement reflects the value of the agreement relative to a standard PTA.

Estimates

Column 1 of Table 2 below reports coefficient estimates for our benchmark model. The positive and significant coefficient of PTA can be interpreted as the average effect of trade agreements increasing exports of their members by about 19% (=exp(0.172)-1). Recall, all other PTA coefficients measure the additional effect on their members' exports compared to average PTA effect. The EU coefficient is also positive and significant and is the highest of all PTA coefficients. It can be translated as EU membership increasing exports above a standard PTA by 47% , or a total of about 66%.

The positive and significant estimate of *US_MENA* implies an additional increase in trade by 38% between the US and MENA countries having a PTA. In contrast, EU-MENA is negative and significant and similar in magnitude to the typical PTA effect,

6 Country-pair importer-exporter fixed effects also attenuate the potential endogeneity bias of the PTA variable in a gravity equation due to the potential correlations of error terms and PTA caused by omitted regressors. Indeed, there may be unobserved characteristics between two trading partners (e.g. their relative difference of factor endowments, or their remoteness from the rest of the world) that affect the probability to sign a PTA and that may also explain the volume of trade between partners. Baier and Bergstrand (2007) find that the source of endogeneity bias of PTAs is unobserved time-invariant heterogeneity and that they are best controlled for using "bilateral fixed effects" in a panel context.

implying that, unlike joining the EU, a trade agreement with the EU has no significant effect on trade for MENA countries.

Table 2 Estimates for total imports

	Dependent Variable: ln(total imports)					
	1		2		3	
	coeff	% change in imports	coeff	% change in imports	coeff	% change in imports
PTA	0.172***	19%	0.171***	19%	0.176***	19%
	[0.023]		[0.023]		[0.023]	
EU	0.382***	47%	0.385***	47%	0.38***	46%
	[0.037]		[0.037]		[0.037]	
US_MENA	0.321**	38%	0.113	12%		
	[0.146]		[0.081]			
EU_MENA	-0.174***	-16%	0.001	0%	-0.178***	-16%
	[0.041]		[0.049]		[0.041]	
TURKEY_MENA	-0.502***	-39%	-0.202	-18%	-0.507***	-40%
	[0.098]		[0.126]		[0.097]	
GAFTA	-0.113*	-11%	-0.113*	-11%	-0.118*	-11%
	[0.068]		[0.068]		[0.068]	
AGADIR	0.048	5%	0.045	5%	0.045	5%
	[0.107]		[0.107]		[0.107]	
US_MENA_MNAExp			0.403	50%		
			[0.286]			
EU_MENA_MNAExp			-0.347***	-29%		
			[0.074]			
TUR_MENA_MNAexp			-0.599***	-45%		
			[0.174]			
PRE_EU_PTA	0.119***	13%	0.121***	13%	0.117***	12%
	[0.034]		[0.034]		[0.034]	
US_MENA_exclJOR					-0.157	-15%
					[0.108]	
Observations	230279		230279		230279	
R-squared	0.9		0.9		0.9	

Notes: Robust standard errors in brackets. * significant at 10%; ** significant at 5%; *** significant at 1%. All regressions include importer-year and exporter-year fixed effects, as well as exporter-importer country-pair fixed effects. PTA is a dummy variable that is one when an exporter faces preferences in an importer's market under a preferential trade agreement; it includes all PTA agreements as defined by CEPII (http://www.cepii.fr/anglaisgraph/bdd/gravity.asp). The other variables (EU, US_MENA, EU_MENA, TURKEY_MENA, GAFTA, and AGADIR) are dummy variables identifying trade partners involved in these specific agreements. The full effect of each specific agreement is the sum of the coefficient on the particular agreement and the coefficient on PTA. For a given agreement (####), the variables ####_MNAExp are used to identify when a MENA country is an exporter under the #### agreement. For example, US_MENA_MNAExp is an indicator identifying MENA countries exports to the US under a US_MENA trade agreement. A significant coefficient on this variable indicates that MENA exporters face different access to the US under the agreement, as compared with the access faced by the US in MENA partners. When these variables are included, the full effect on MENA exports to the partner is accounted by PTA + #### + ####_MNAExp and the effect on MENA imports from the partner is accounted by PTA + ####.

Turkey-MENA is negative, significant and bigger than the PTA coefficient, implying that the agreement has a negative overall effect on trade. Regarding intraregional PTAs, GAFTA records a trade impact 11% lower than the average PTA, whereas AGADIR's coefficient is positive but not significant implying that the agreement is not significantly different from other standard PTAs.

To decompose the impact on the exports from MENA countries of PTAs, we interact a dummy, *MNAExp* (taking the value of one when a MENA country is exporter and zero otherwise) with *US_MENA, EU_MENA*, and *TUR_MENA*, and incorporate them in the regression. In this specification, the bilateral variable (such as *US_MENA*) picks up the effect on the external partner's export to MENA (or the effect on MENA's imports from the external partners), and the additive effect of the two coefficients (e.g. *US_MENA* and *US_MENA_MNAExp*) picks up the effect on MENA's exports to the external trade partner (or the effect of external partner's import from MENA partners). This is only valid for agreements with countries outside MENA, since in intra MENA agreements the exporter and importer are both in the region.

Estimates of export and import effects, reported in column 2, show that, of the external agreements, only the US-MENA agreements have a positive and significant effect on MENA exports to their partners. EU-MENA and Turkey-MENA agreements have negative effects on MENA's export to the EU and Turkey, respectively, whereas the effect of EU exports to MENA countries is not significantly different than the standard PTA effect, and the Turkey agreement has not significantly affected Turkish exports to MENA.

In the case of US agreements, and as we have seen with the graphs, the biggest increase was in Jordan's exports to the US. Next, we replace the *US_MENA* dummy with *US_MENA_exclJOR*, a dummy that excludes Jordan from US agreements with MENA countries. Estimates in column 3 show that its coefficient is negative and non-significant. This implies that the additional estimated effect of US-MENA PTA dummy in column 1 is driven entirely by trade between Jordan and the US. As shown in Figure

2, the surge in Jordanian exports to the US started before the implementation of the US-Jordan PTA and is likely due to preferences granted to Jordanian QIZs. Therefore, QIZ may have accounted more of the trade-expanding effect captured by the *US_MENA* dummy than by trade preferences under the US-Jordan PTA. Other agreements between US and MENA countries have had, if anything, less than the standard PTA impact.

For comparison, we also include the variable *PRE_EU_PTA* in all regressions, which captures the trade-effect of preferential agreements granted by the EU to European countries that were in the process of negotiating EU accession (prior full EU membership), which is estimated to be about 13% larger than the standard PTA effect. Thus, the effects of intra-MENA agreements and EU-MENA agreements are well below the effect of similar agreements in which members were negotiating accession with the EU. One explanation is that the trade preferences were greater in these cases. An alternative is that these estimates incorporate anticipatory effects of accession. Country-pair fixed effects should pick up the extent to which these countries are natural trade partners.

In sum, the results suggest that trade preferences to MENA countries granted by the US, EU, and Turkey do not have an additional effect compared to other PTAs. In the case of preferences by the EU and Turkey, they are shown to have a lower impact. In contrast, GAFTA and AGADIR have an additional export-expansion effect on their members, although the effect of GAFTA is lower than the average PTA. If trade agreements are going to be used as a tool to integrate MENA countries, they will have to be much deeper than what is currently in force.

Robustness

Next, we re-estimate the gravity model on imports that exclude oil and other natural resources for robustness. Estimates in Tables 3 and 4 run the same specifications as Table 1 but with non-oil imports and non-natural-resources imports, respectively, as dependent variables. Estimated coefficients are very close to those in Table 2. The export-increasing effect of PTAs is slightly reduced to 17% and 15% in the case non-oil imports and non-natural resources imports, respectively, whereas the EU effect increases to 52% in the case of non-oil imports, and to 68% in the case of non-natural-resource imports. In these regressions, GAFTA and AGADIR have non-significant coefficients, which is evidence that the trade-effects agreements are not significantly different than other agreements in these commodities.

Table 3 Estimates for non-oil imports

	Dependent Variable: ln(non-oil imports)					
	1		2		3	
	coeff	% change in imports	coeff	% change in imports	coeff	% change in imports
PTA	0.157***	17%	0.156***	17%	0.161***	17%
	[0.022]		[0.022]		[0.022]	
EU	0.419***	52%	0.421***	52%	0.416***	52%
	[0.036]		[0.036]		[0.036]	
US_MENA	0.35**	42%	0.137*	15%		
	[0.164]		[0.075]			
EU_MENA	-0.133***	-12%	-0.015	-1%	-0.138***	-13%
	[0.039]		[0.047]		[0.039]	
TURKEY_MENA	-0.398***	-33%	-0.163	-15%	-0.403***	-33%
	[0.086]		[0.120]		[0.086]	
GAFTA	-0.074	-7%	-0.074	-7%	-0.079	-8%
	[0.065]		[0.065]		[0.064]	
AGADIR	-0.019	-2%	-0.021	-2%	-0.022	-2%
	[0.097]		[0.097]		[0.097]	
US_MENA_MNAExp			0.415	51%		
			[0.324]			
EU_MENA_MNAExp			-0.237***	-21%		
			[0.069]			
TUR_MENA_MNAexp			-0.47***	-37%		
			[0.156]***			
PRE_EU_PTA	0.121***	13%	0.122***	13%	0.118***	13%
	[0.033]		[0.033]		[0.033]	
US_MENA_exclJOR					-0.154	-14%
					[0.143]	
Observations	229686		229686		229686	
R-squared	0.91		0.91		0.91	

Notes: Robust standard errors in brackets. * significant at 10%; ** significant at 5%; *** significant at 1%. All regressions include importer-year and exporter-year fixed effects, as well as exporter-importer country-pair fixed effects. See notes on Table 2 for a description of the variables.

In column 1 of Tables 3 and 4, the EU_MENA dummy and Turkey_MENA are still negative and significant, and the US-MENA dummy is still positive and significant.

Table 4 Estimates for non-natural-resources imports

	Dependent Variable: ln(non-natural res. imports)					
	1		2		3	
	coeff	% change in imports	coeff	% change in imports	coeff	% change in imports
PTA	0.144***	15%	0.143***	15%	0.148***	16%
	[0.023]		[0.023]		[0.023]	
EU	0.515***	67%	0.517***	68%	0.513***	67%
	[0.037]		[0.037]		[0.037]	
US_MENA	0.326**	39%	0.123*	13%		
	[0.163]		[0.074]			
EU_MENA	-0.118***	-11%	0.001	0%	-0.122***	-11%
	[0.040]		[0.048]		[0.040]	
TURKEY_MENA	-0.429***	-35%	-0.157	-15%	-0.434***	-35%
	[0.091]		[0.117]		[0.091]	
GAFTA	0.063	7%	0.063	7%	0.058	6%
	[0.070]		[0.070]		[0.070]	
AGADIR	0.029	3%	0.027	3%	0.026	3%
	[0.105]		[0.105]		[0.105]	
US_MENA_MNAExp			0.394	48%		
			[0.321]			
EU_MENA_MNAExp			-0.238***	-21%		
			[0.071]			
TUR_MENA_MNAexp			-0.545***	-42%		
			[0.162]			
PRE_EU_PTA	0.173	19%	0.174***	19%	0.17***	19%
	[0.033]***		[0.033]		[0.033]	
US_MENA_exclJOR					-0.193	-18%
					[0.136]	
Observations	227411		227411		227411	
R-squared	0.91		0.91		0.91	

Notes: Robust standard errors in brackets. * significant at 10%; ** significant at 5%; *** significant at 1%.

All regressions include importer-year and exporter-year fixed effects, as well as exporter-importer country-pair fixed effects. See notes on Table 2 for a description of the variables.

Finally, estimates in columns 3 of both tables show not only that the trade-increasing effect of US-MENA agreements beyond the average PTA is entirely driven by Jordan, but also that US-MENA PTAs have no additional impact on both non-oil imports and non-natural resources imports than the standard PTA when the US agreement with Jordan is excluded.

Conclusions

This chapter estimates the effects of MENA's trade agreements. While intraregional agreements are estimated to perform about as well as standard trade agreements, the agreements with the EU, US, and Turkey have typically accomplished less. As compared with a deeper agreement like the EU, or even the agreements that the EU signed with European countries negotiating EU accession prior to full EU membership, effects have been especially modest. Considering that the trade base is very low to begin with, the trade growth accomplished by these agreements has been underwhelming.

Moving forward, there is currently a lot of discussion about new initiatives to stimulate trade with MENA as a way for the rest of the word to help the region grow and create jobs in the aftermath of the Arab Spring. The Deauville Partnership is a prime example, where G8 countries in cooperation with the GCC and Turkey have offered to work with Egypt, Morocco, Libya, Jordan and Tunisia to stimulate trade and investment. The partnership is focused on deeper integration, including better access for agriculture in the EU and more openness to investment and lower nontariff barriers in MENA.[7] But the partnership is at an early stage, and has so far involved a much higher level of discussion than action. It will require serious commitment and implementation from both sides for the benefits to be realised. If countries do not make significant steps in opening trade and investment channels, such efforts could involve a waste of scarce government resources that could be spent on more productive endeavours.

7 See World Bank (2012) for an overview of the process and recommendations for integration.

The analysis in this chapter strongly supports the importance of deeper integration; EU membership has proven truly unique in its ability to stimulate trade, with effects that are three times as large as a standard PTA. Even preferential agreements between countries negotiating EU accession and the EU have a stronger effect than the standard PTA. However, the analysis in this chapter also cautions against “more of the same”. That is, the EU-MENA and US-MENA agreements that are in force now were aimed at stimulating trade with members but in practice have had, at best, a marginal impact. If the Deaville Parntership is to be successful it must go well beyond past agreements, approaching a deeper integration as is observed among EU countries. If the political will is absent, then alternative paths should be considered to stimulate trade and investment. Importantly, reform in the MENA countries is likely to have a greater impact on trade and investment than more access from their trade partners, implying that gains from trade are largely in their own hands. Reforms to generate a supply response include improved governance, leaner and uniformly applied business regulations, competitive exchange rates, more transparent tax structure, greater openness to trade and FDI, and more flexible labour markets.

While intraregional integration remains below potential, our results show that GAFTA and AGADIR are working to stimulate trade in non-oil goods with an impact statistically no different from the standard PTA. Indeed they have had greater and broader effects than agreements with the EU, Turkey, or the US. This is also supported by results from Behar and Freund (2012), which show that the extent of under-trading intraregionally is declining faster than under-trading externally.

But intraregional integration is not a substitute for global integration. Although the agreements have facilitated trade, initial trade is very low as the countries are not natural trade partners, so the gains from expanded trade are small. In addition, an important concern is that there are too many overlapping and partial agreements, and that this “spaghetti bowl” will serve as a distraction of scarce trade negotiating resources. Ultimately, the largest gains from trade are likely to come from integration with countries outside the region, where comparative advantage and linkages through supply chains can be exploited. Moreover, while creating an intraregional bloc can encourage foreign investment to take advantage of the larger market, this can only happen if governance improves and the regulatory environment is fair and lean. What might make the intraregional agreements more valuable is if they facilitated improved governance, supported regulatory harmonisation, facilitated labour mobility, and promoted services trade. As pure regional trade initiatives, they may increase trade above current levels but, given the low base, the gains are marginal.

In sum, regional integration can help the MENA countries stimulate trade and investment, but the largest gains are likely to come from domestic reforms. Given the relatively small effects of existing regional integration agreements in MENA, pursuing this route is unlikely to prove successful unless agreements are much deeper and domestic reforms are pursued.

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Annex A: Membership of PTAs

EU-MENA FTA

Euro Mediterranean Association Agreements

MENA country	Entry into force
Algeria	2005
Egypt	2004
Jordan	2002
Lebannon*	2003
Morocco	2000
Palestian Authority	1997
Syria	Not yet
Tunisia	1998

Notes: *In process of ratification. Interin Agreement for early implementation of trade measures

Source: European Commission (2007).

US-MENA PTAs & US-Israel FTA

MENA country	Entry into force
Jordan	2001
Morocco	2006
Bahrain	2006
Oman	2009
Israel	1985
Lebanon	not yet

Source: Office of the United States Trade Representation, http://www.ustr.gov/trade-agreements/free-trade-agreements

TURKEY-MENA FTA

MENA country	Entry into force
Tunisia	2005
Morocco	2006
Syria	2007
Egypt	2007
Palestian Authority	2005

Source: Customs Tariff information and legislation of Turkey in English, http://www.tariff-tr.com/bul/AraBul2007.aspx?yur=1&a2=Turkey's%20Bilateral%20Agreements

INTRA-MENA Agreements

GAFTA - also known as PAFTA Greater Arab Free Trade Agreement Entry into force: 1998 MENA country members:
Bahrain
Egypt
Iraq
Jordan
Kuwait
Lebanon
Libya
Morocco
Oman
Qatar
Saudi Arabia
Syria
Sudan
Tunisia
United Arab Emirates
Yemen
Palestinian Authority
Source: GAFTA website, http://www.mit.gov.jo/Default.aspx?tabid=732

AGADIR Agadir Agreement for the Establishment of a Free Trade Zone between Arabic Mediterranean Nations Entry into force: 2007 MENA country members:
Egypt
Jordan
Morocco
Tunisia
Source: AGADIR website, http://www.agadiragreement.org/Home.aspx#

This volume draws together the reflections of a group of distinguished scholars and specialists on the role of economic integration for the countries of the MENA region. The timing is apposite bearing in mind the dramatic changes in these societies, the ongoing changes in the world economy, and also the pressing economic and social need for higher rates of economic growth in the region. The volume includes two types of contributions: country-specific analyses from leading country experts on Egypt, Morocco and Syria; and more formal cross-country analyses that take a broader perspective on the role of trade and integration.

There are several common themes that emerge:

- The relatively low growth rates and relative lack of export success/dynamism in most of the region's countries.
- The importance of trade and integration in improving the competitiveness of the regions' countries and, through that, impacting on their capacity for economic growth.
- The close interface between appropriate institutions, regulatory frameworks and infrastructure, and international integration.
- The need for much more than reductions in tariff barriers alone for effective trade liberalisation.
- The need for the domestic political will to introduce reforms, to provide better incentives for investment and private sector activity, and to reduce corruption.

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