IMF Working Paper

WP/97/5

INTERNATIONAL MONETARY FUND

Middle Eastern Department

Adjusting to New Realities: MENA, The Uruguay Round, and the EU-Mediterranean Initiative

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January 1997

Abstract

This paper addresses concerns that the Middle East and North Africa (MENA) region, with the exception of the GCC economies, has lagged behind in trade liberalization. This delay has adversely affected production efficiency and consumer welfare and could reduce the region's ability to attract foreign investment. Against this background, the paper examines the major challenges facing MENA if it is to benefit from the opportunities presented by the Uruguay Round and the European Union Mediterranean Initiative. It concludes with an overview of measures that MENA countries will need to implement to benefit from these trade-enhancing initiatives.

JEL Classification Numbers: F1, F4

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[1]We are grateful to Mohamed A. El-Erian, Henri Ghesquiere, Abdelali Jbili, Saleh Nsouli, and Shahpassand Sheybani for helpful comments. The statistical assistance received from Peter Kunzel is very much appreciated. We are also grateful to Maureen Burke for secretarial assistance. The views expressed in this paper are those of the authors and do not necessarily reflect those of the International Monetary Fund.

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SUMMARY

The MENA region, with the exception of the GCC economies, is lagging behind in trade liberalization. This delay has had a negative impact on production efficiency and consumer welfare and will become more costly given the increasing globalization and integration of the world economy. It is also likely to reduce the region's attractiveness for foreign investment. The region has yet to take sufficient advantage of the remarkable growth in international trade and risks missing out on the added opportunities presented by the current multilateral trade liberalization arrangements—the Uruguay Round and the European Union Mediterranean Basin Initiative.

The paper describes the trade characteristics of the MENA region and considers past and ongoing trade reform efforts of certain countries, including in the context of Fund supported adjustment programs. It discusses the advantages of further trade liberalization in achieving higher and sustainable rates of growth and improving the welfare of the region's population. It considers MENA's participation in the Uruguay Round and the EU's Mediterranean Basin Initiative and addresses the opportunities presented by these initiatives. The paper concludes with an overview of measures that MENA countries will need to implement to benefit from these multilateral trade-enhancing initiatives.

I. INTRODUCTION

The last four decades have seen a remarkable growth in international trade. World trade grew by about 9 percent in 1994 and 1995—more than twice that of world output—and is estimated to grow by some 6 percent annually over the next decade. This, together with the opportunities presented by recent multilateral trade arrangements—the Uruguay Round and the European Union's Mediterranean Basin Initiative—have opened up new economic growth opportunities for countries in the Middle East and North Africa (MENA) region—countries which have not been active participants in the world trading environment thus far.[1]

The benefits of greater integration are clear: studies have shown that closer integration, specifically through trade reform, leads to a higher level of economic growth as a result of improved resource allocation and economic efficiency. Furthermore, by increasing competitiveness of domestic production, trade reform can enhance export prospects, leading to an improvement in the trade balance and the overall balance of payments position. Other spillover effects from trade—higher productivity levels that stem from technology transfers from the industrial countries and the interaction between trade and the stock of foreign research and development capital—are also clear.

This paper examines the major challenges facing MENA as a result of recent developments in the international trading environment. It is organized as follows: Section II describes the trade characteristics of the MENA region. Section III considers trade reform efforts of MENA countries within the framework of intraregional agreements, as well as under Fund-supported arrangements. The implications of recent multilateral trade liberalization initiatives—the Uruguay Round and the European Union's Mediterranean Initiative—for the MENA countries are examined in Sections IV and V, respectively. The final section—Section VI—reviews the policy measures MENA countries will need to implement if they are to benefit from these initiatives, and draws conclusions from the earlier sections.

II. OVERVIEW OF MENA TRADE

The countries of the MENA region are highly diverse in terms of their economic and geographical size, natural resource endowments, and standards of living. These characteristics in turn have an important impact on the region's pattern of trade, and explain to some extent the variations in the trade policy orientation of different countries in the region.

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[1]The MENA region is defined here as including the 21 members of the Arab League (Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates and Yemen), as well as the Islamic Republic of Iran and Israel.

With regard to the composition of MENA trade, exports are highly concentrated in mineral fuels, which constitute about two thirds of total MENA exports (Chart 1). (Petroleum exports account for some 70 percent of total exports of the countries of the Gulf Cooperation Council (GCC),[2] while Algeria, Egypt, Iran, Iraq, Libya and Syria are also oil exporters.) Manufactured goods represent the next most important category of exports (20 percent), one fourth of which is accounted for by exports of textiles and clothing. (Textile and clothing exports make up more than 50 percent of total manufactured exports for Egypt, Morocco, Syria and Tunisia). Raw materials and chemicals make up 9 percent of total exports, while foodstuffs constitute only 4 percent of total exports. On the other hand, imports are dominated by manufactured goods (constituting about two thirds of total MENA imports). The region is also dependent on food imports, which represent close to 15 percent of total imports, and a much higher proportion in a number of MENA countries, particularly those of the GCC.

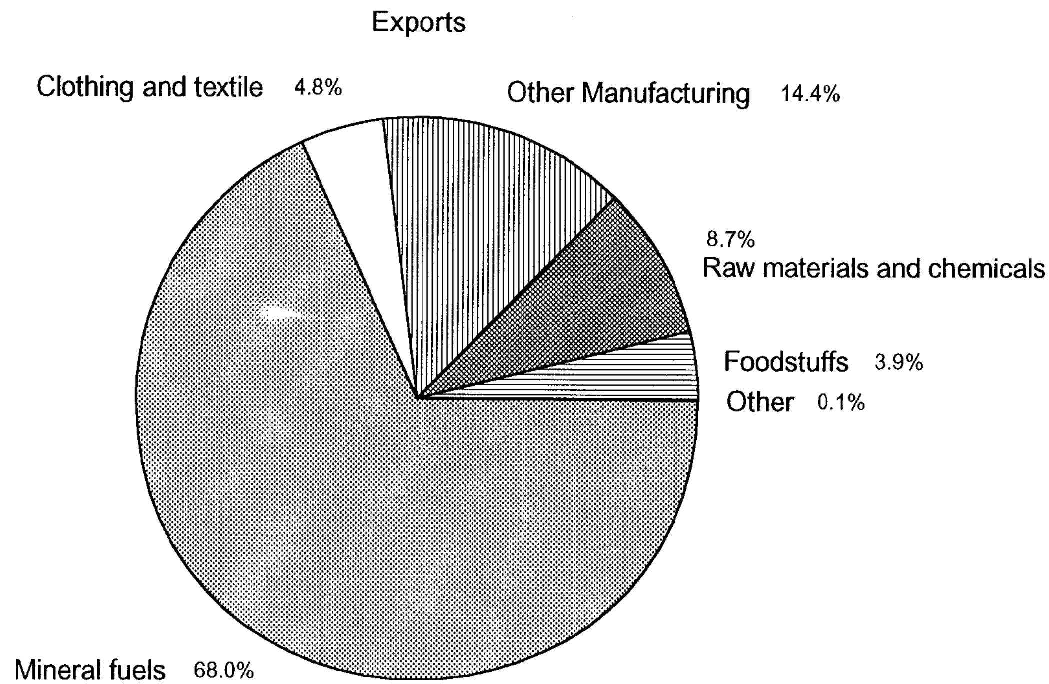
The high concentration of MENA trade, together with the variability of international oil prices, account for the volatile pattern of MENA's terms of trade, particularly in comparison with other regional groupings. Over the period 1990-95, MENA's terms of trade have fluctuated to a much greater extent than those of both developing and industrial countries (Chart 2). El-Erian (1996) estimates that, over the period 1989-94, MENA's terms of trade fluctuated 15 times more than developing countries as a group and 30 times more than industrial countries.

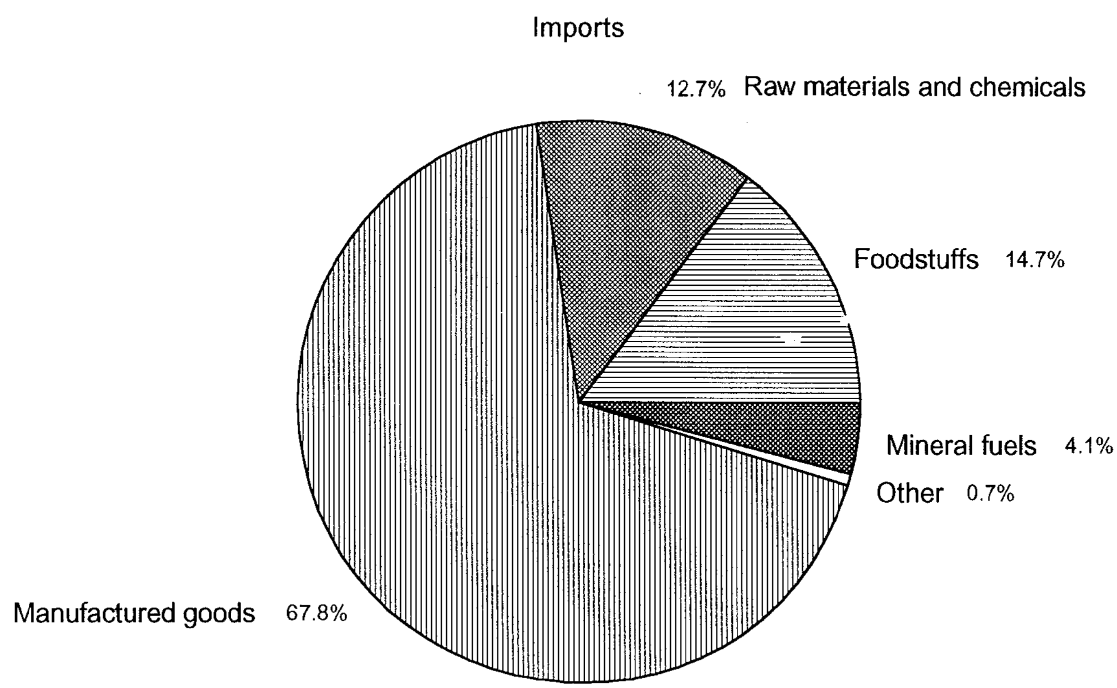
The MENA region is relatively dependent on the European Union as a market for its exports and a source of its imports—about 30 percent of total MENA exports are directed to the EU, and 44 percent of total MENA imports (Chart 3). Nonetheless, the share of MENA exports in the EU import market is small and, more worryingly, has declined markedly in the past decade and a half, from 24 percent of total EU imports in 1980 to just over 8 percent in 1994 (Table 1). While this decline represents in part a fall in oil prices, it is also accounted for by a loss of competitiveness and greater market penetration by Asian and East European countries. Japan absorbs some 16 percent of total MENA exports and accounts for 8 percent of imports. The United States is a relatively less important trade partner at present (11 percent of exports and 12 percent of imports).

The limited extent of intraregional trade among MENA countries is particularly noteworthy. Intraregional trade represents the smallest share in total trade; less than 8 percent of total exports, and 8 percent of total imports. This compares unfavorably with other regions, including Asia, the EU, and Western Hemisphere (Table 2). The limited nature of intra-MENA trade can be explained in part by the relative similarity of resource endowments among many countries in the region, the greater proximity of the Maghreb countries to Europe than to other MENA countries, continued high levels of protection, and the impact of conflicts in the region, particularly the prolonged Arab-Israeli conflict. Nevertheless, such a

[2]The GCC includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the U.A.E.

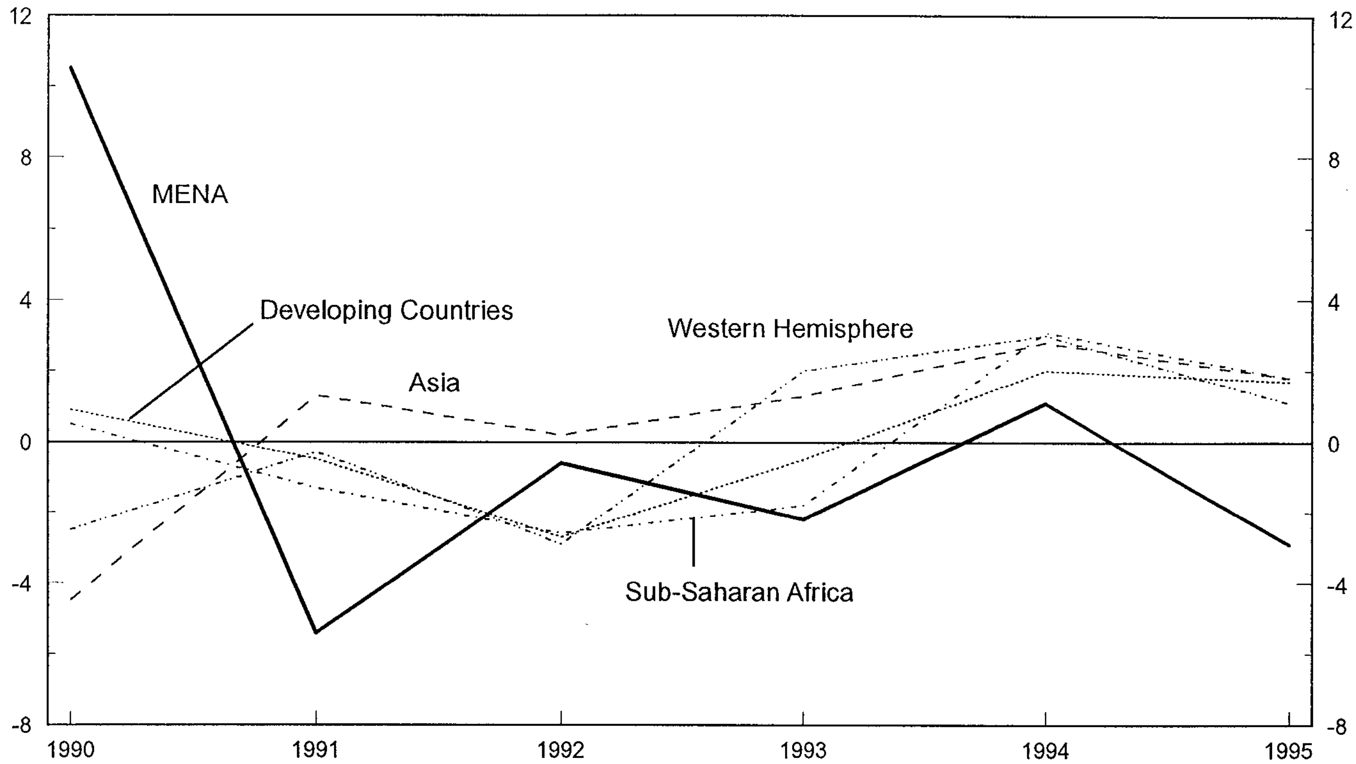
Chart 1.
MENA: Composition of Trade
(In percent; 1990-94 averages)

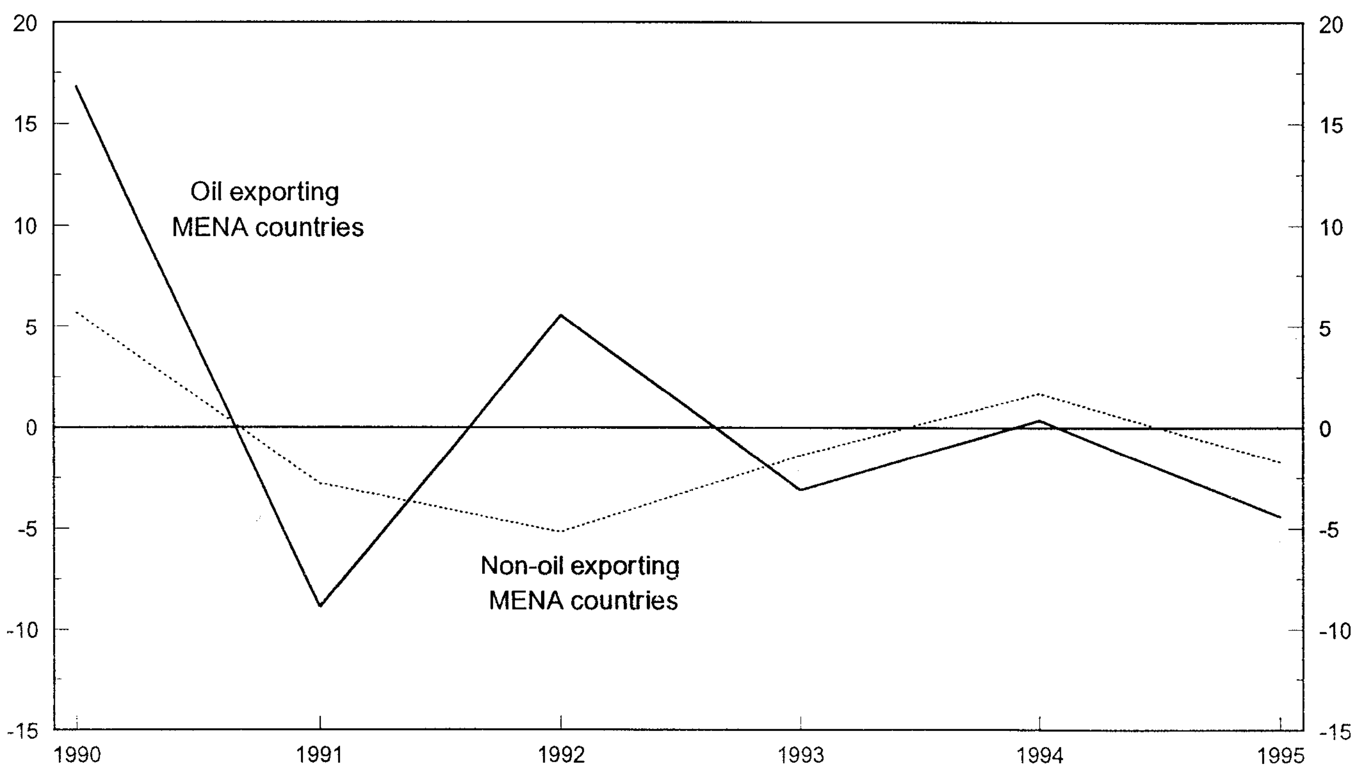




Source: United Nations, Trade Analysis and Reporting System.

Chart 2
MENA Region: Terms of Trade, 1990-95
(Annual percent changes)

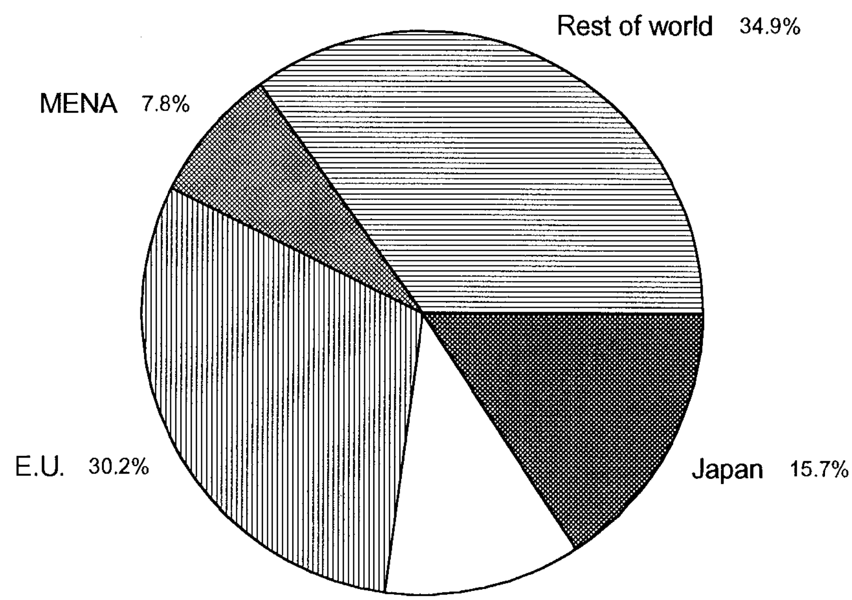




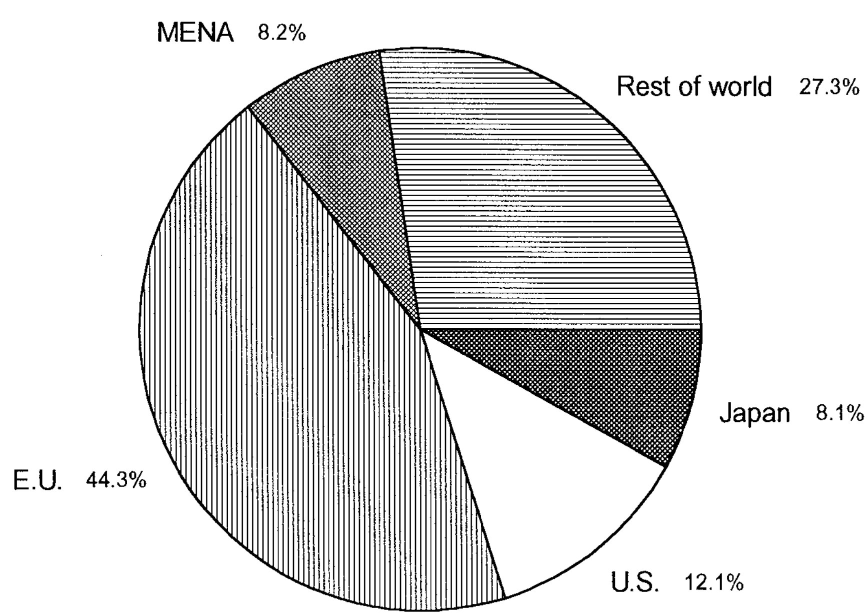
Source: IMF, World Economic Outlook.

Chart 3.
MENA: Direction of Trade
(In percent; 1990-95 averages)

Destination of Exports



Sources of Imports



Source: IMF, Direction of Trade.

Table 1. Share of MENA Exports in EU Markets, 1980-94

(Percentage share in total EU imports)[1]

	1980	1985	1990	1994
	(in percent)			
Southern Mediterranean				
Algeria	1.63	2.94	1.61	1.11
Egypt	0.97	1.09	0.54	0.51
Israel	0.67	0.76	0.86	0.82
Jordan	0.01	0.07	0.02	0.02
Lebanon	0.02	0.02	0.02	0.02
Libya	2.83	3.03	1.81	1.14
Morocco	0.51	0.53	0.69	0.69
Syria	0.35	0.29	0.29	0.30
Tunisia	0.50	0.41	0.52	0.60
Sub-total	7.49	9.13	6.36	5.20
Other MENA				
Bahrain	0.03	0.04	0.03	0.02
Djibouti	0.00	0.00	0.00	0.00
Iran	1.38	1.77	1.41	0.93
Kuwait	1.39	1.18	0.38	0.25
Mauritania	0.06	0.07	0.05	0.04
Oman	0.14	0.05	0.07	0.03
Qatar	0.62	0.19	0.01	0.01
Saudi Arabia	10.55	2.31	1.81	1.60
Sudan	0.07	0.05	0.04	0.03
Somalia	0.01	0.01	0.01	0.00
U.A.E.	1.93	0.49	0.38	0.13
Yemen	...	...	0.17	0.04
Total MENA	23.67	15.28	10.73	8.28
Comparators:				
China	0.76	1.02	2.35	4.30
Hungary	0.64	0.68	0.89	1.13
Korea	0.82	0.94	1.66	1.78
Poland	1.22	1.12	1.42	1.92

Source: IMF, Direction of Trade Statistics.
[1]Excludes intra-EU trade.

Table 2. Intraregional Trade

(Percent of Total Trade)

	1991	1992	1993	1994	1995
MENA	7.7	7.7	8.0	8.4	7.2
Developing Countries	37.0	37.6	38.4	39.8	40.6
Asia	34.7	36.1	35.8	37.0	37.4
Sub-Saharan Africa	5.8	5.7	7.3	8.1	8.2
Western Hemisphere	17.9	17.7	18.2	18.5	18.2
EU	64.8	65.2	60.8	60.7	61.3

Source: *Direction of Trade Statistics.*

situation is disappointing, as most studies conclude that the levels of intraregional trade are well below the potential attainable under a more open and liberal trade strategy, although it is recognized that trade with other regions will continue to dominate.

The region as a whole appears relatively open—with a total trade-to-GDP ratio of some 70 percent, higher than in most industrial and developing countries, and surpassed only by Asia (Table 3). Although this level appears high by international standards, it is important to note that it is significantly influenced by the sizable oil exports and basic food imports of the region. The particular factor endowments of the region (rich in oil and a shortage of water) result in a comparatively high traded goods ratio. Nevertheless, MENA economies remain relatively closed owing to still substantial tariff and non-tariff barriers and restrictions on trade in services. Furthermore, developments in openness reveal an unfavorable trend. The trade-to-GDP ratio for MENA averaged 84 percent in 1976-80, thereafter declining to a low of only 60 percent in 1986-90, before recovering partly to 70 percent in 1991-95 (Table 4). While these ratios are influenced by variations in MENA's terms of trade, even abstracting from such variations, MENA's *real* trade-to-GDP ratio declined considerably during 1975-84 and has risen at a very slow rate since then, far slower than for all other regions, excluding Sub-Saharan Africa (World Bank, 1996). Looking at another indicator of openness/global integration over a more recent period, per capita exports have declined by 5 percent for the MENA region between 1990 and 1995, while they grew by 20 percent for the developing countries as a group and by 10 percent for the industrial countries over the same period.

Table 3. Openness Indicators: MENA and other Regions, 1990-95

	1990	1991	1992	1993	1994	1995	Average 1990-95
			Trade to GDP ratios (In percent)				
MENA	71	74	71	69	68	66	70
Developing Countries	53	54	55	55	55	58	55
Sub-Saharan Africa	57	58	59	61	73	70	63
Asia	65	69	71	74	75	78	72
Western Hemisphere	28	28	29	28	28	31	29
Industrial Countries	37	36	35	34	35	38	36
			Per Capita Exports (In U.S. dollars)				
MENA	742	696	719	673	683	719	705
Developing Countries	249	256	277	291	325	381	297
Sub-Saharan Africa	104	98	95	88	92	102	97
Asia	189	211	235	259	300	362	259
Western Hemisphere	381	371	385	404	451	524	420
Industrial Countries	3889	3910	4176	4046	4454	5178	4,276

Source: IMF, World Economic Outlook, May 1996.

Table 4. Trade to GDP Ratios in MENA Countries, 1976-95[1]

(In percent)

	Average 76-80	Average 81-85	Average 86-90	Average 91-95
Algeria	63.6	53.9	32.9	48.6
Bahrain	210.5	206.1	195.1	195.2
Djibouti	113.8	108.0	148.7	177.4
Egypt	55.2	54.1	48.6	71.6
Iran, Islamic Rep. of	54.0	28.1	31.7	49.2
Israel	85.6	82.0	81.9	77.5
Jordan	134.8	151.6	113.2	127.5
Kuwait	108.4	104.9	88.2	99.5
Lebanon	118.3	170.0	187.4	104.1
Libya	93.8	86.2	54.5	46.0
Mauritania	99.0	126.5	89.9	91.8
Morocco	48.9	54.7	50.3	50.6
Oman	105.6	94.6	79.6	81.6
Qatar	106.1	91.6	74.5	82.3
Saudi Arabia	121.5	120.7	98.7	90.3
Somalia	41.3	25.8	40.3	41.3
Sudan	33.1	33.8	24.0	43.2
Syrian Arab Rep.	58.8	38.9	25.8	25.3
Tunisia	69.8	81.2	81.2	86.8
United Arab Emirates	109.8	89.5	91.2	119.9
Yemen,Rep. of	56.3	43.2	39.5	35.6
MENA	84.2	72.8	60.1	70.5

Source: IMF, World Economic Outlook, May 1996.
[1]Merchandise and service trade.

These aggregate figures conceal significant diversity in the extent of openness of individual countries in MENA. In general, the more open economies are the major oil exporters (specifically, the GCC) and those countries that are highly dependent on basic food imports (generally in the form of aid), including Djibouti, Egypt, and Mauritania. Trade in these commodities under the circumstances is less of a policy option and can be substantial even in otherwise closed economies. Indeed, if trade in oil and foodstuffs are excluded, remaining trade turns out to be quite small and the region appears substantially less open. As would be expected, those countries that have pursued more inward-oriented macroeconomic policies in the past—including, most notably, Iran, Libya, Sudan, and Yemen—have much lower trade/GDP ratios than others in the region. However, even in these countries, policy makers are beginning to recognize the need to reorient their policy stance, and have begun to implement trade liberalization in the context of broader structural reforms, including under Fund-supported arrangements (Yemen).

Most of the region's non-oil economies have in place significant tariff and nontariff trade barriers. The tariff rates and descriptions of the trade regimes of individual MENA countries are presented in Table 5. While average import customs rates in the GCC are relatively low—as low as 5 percent in Bahrain and U.A.E., the trade regimes of the non-GCC MENA countries tend to be much more restrictive—with an average customs tariff as high as 30 percent in Egypt, Jordan, Mauritania, and Tunisia, and with significant quantitative restrictions and bans in Egypt, Jordan, Iran, Libya, Syria, and Yemen. Looking at a sub-group of MENA countries—the southern Mediterranean basin countries (Table 6)—the weighted average tariff rates in all countries in this group, except for Israel, are more than double the international average. The broadly restrictive stance of the region reflects in part the legacy of the inward-oriented policies pursued in the 1960s and 1970s, when many MENA countries adopted development strategies aimed at import substitution and self-sufficiency goals that usually involved the imposition of extensive barriers to trade (Sachs, 1996 and El-Naggar, 1992)

III. Trade Reforms in MENA: Past and Recent Experience

It is clear from the indicators provided in Section II that the MENA region lags behind other regions in terms of its participation in the global economy, particularly with respect to trade linkages with the rest of the world. A positive association has been established between an outward-oriented trade strategy and enhanced allocative efficiency, growth, and employment. An opening of the economies of MENA countries would thus be an important prerequisite for attaining high-quality growth. Moreover, export-led growth could be expected to generate employment, an important consideration for MENA countries.

Table 5. MENA Countries—Summary of Customs Tariff and Other Duties and Charges on Imports and Quantitative Restrictions on Imports

	Customs Tariffs (Imports) Min.	Max.[1]	No. of Bands	Other Duties and Charges (Imports)	Quantitative Restrictions	Other Observations
Maghreb countries						
Algeria	3 %	50 %	6	0 % - 6 %	None	Application to WTO pending; EU Association Agreement being negotiated
Morocco	0 %	45 %	19	15 % (fiscal levy) + parafiscal 0.25 %	Yes (agricultural products + specified industrial inputs)	WTO member;EU Association Agreement signed
Tunisia	0 %	73 %	numerous	2 % import customer fee + countervailing import duty	Yes (8 % of domestic production)	WTO member; EU Association Agreement signed
GCC Countries						
Bahrain	4 %[2]	20 %	5	None	Yes (specified items + procurement rules)[3]	WTO member; discussion through GCC with EU to establish free-trade area.
Kuwait	4 %[2]	--	5	None	Yes (specified items + procurement rules)[3]	Same as above
Oman	5 %[2]	--	6	None	Yes (refined petroleum products)[3]	Same as above
Qatar	4 %[2]	--	3	None	Yes (very few; imports from specified countries)[3]	Same as above
Saudi Arabia	0 %	20 %	3	None	Yes (very few; imports from specified countries)[3]	WTO membership under discussion; discussions through GCC with EU to establish free-trade area
UAE	4 %	4 %	--	None	Yes (same as above)[3]	Became member of GATT in 1994; final act of the Uruguay Round not yet finalized
Mashrek countries						
Egypt	5 %	70 %	--	2 % and 5 % import surcharges	Yes (import bans on poultry, textiles, and garments)	WTO member; EU Association Agreement being negotiated
Jordan	0 %	50 %	8	0.1 % import license fee + 10 % exchange permit fee for imports	Yes (import bans on 5 commodities)	WTO accession under discussion; EU Association Agreement being negotiated

Table 5. MENA Countries—Summary of Customs Tariff and Other Duties and Charges on Imports and Quantitative Restrictions on Imports

	Customs Tariffs (Imports)			Other Duties and Charges (Imports)	Quantitative Restrictions	Other Observations
	Min.	Max.[1]	No. of Bands			
Lebanon	0 %	50 %	12	None	Yes (on specified commodities, bans on imports from certain origin)	Potential candidate for EU Association Agreement
Syria	0 %	200 %	n.a.	2 % import license fee + other specific import fees + 6-35 % import surcharge	Yes (numerous and complex)	Potential candidate for EU Association Agreement
Others						
Iran	0 %	25 %	n.a.	30 % special tax on car imports and other registration fees for imports	Yes (specified imports by origin + commodity)	Asked for observer status in WTO
Israel	0 %	100 %	85	Variable levies on some agricultural products + 2 % port fee + 1.5 % other tariff	Yes (agricultural products for health and sanitary reasons)	WTO member; EU Free Trade Agreement signed
Libya	0 %	100 %	n.a.	Numerous excise taxes on a number of commodities	Yes (specified imports by origin + annual commodity budget)	
Mauritania	0 %	30 %	33	0 or 5% customs duties + 3 % statistical duties + 9 % for veterinary imports	None	WTO member
Yemen	5 %	30 %	4	0.4 - 2 % service fees	Yes (ban for noneconomic reasons; few agricultural products and used vehicles)	

[1]Excluding alcoholic beverages, tobacco products, certain types of automobile and vehicles or other luxury items, depending on country.
[2]Non-GCC countries.
[3]Specified import prohibitions for reasons of religion, health, and national security.

Table 6. Weighted Average Tariff in Southern Mediterranean Countries and Other Regions[1]

(In percent)

	Weighted Avg. Tariff
Algeria[2]	21.6
Egypt	28.0
Israel	7.2
Jordan	19.8
Lebanon	24.2
Morocco	20.3
Syrian Arab Rep.	17.2
Tunisia	31.7
East Asia	21.3
Central Europe	9.1
High Income Countries	5.8
Latin America	14.1
South Asia	47.1
Sub-Saharan Africa	14.8
Developing countries	21.4
World	8.2

Source: Havrylyshyn, 1996 (a).

[1]As of March 1996.
[2]1992

East Asia: Indonesia, Korea, Macau, Malaysia, Philippines, Thailand.
Central Europe: Czech and Slovak republics, Hungary, Poland and Romania.
South Asia: India and Sri Lanka.
Sub-Saharan Africa: Senegal and Zimbabwe.
High Income Countries: Australia, Canada, European Union, Hong Kong, Iceland, Japan, New Zealand, Singapore, Sweden, Switzerland, USA.
Latin America: Argentina, Brazil, Chile, Colombia, Jamaica, Mexico, Peru, El Salvador, Uruguay, and Venezuela.

Significant differences are apparent among MENA countries with respect to their willingness to adopt more outward-oriented policies over the past decade. On the one hand, a number of MENA countries have yet to embrace trade liberalization or are only now recognizing the importance of moving on this front. On the other hand, a number of them—particularly the GCC countries—have been pursuing relatively open trade regimes for a fairly extended period. In general, however, there has been a move among countries in the region toward trade liberalization, including—for some of them—within the framework of Fund-supported adjustment programs.

In contrast to the relatively recent recognition of the need for more open trade with the rest of the world, the importance of developing intraregional links, including through trade, has long been acknowledged among MENA countries. For a variety of reasons, however, efforts at promoting intraregional trade have been largely disappointing.

This section examines first the main reasons why MENA countries need to accelerate trade reform and promote non-oil exports if they are to bolster their growth rates; second, it looks at some of the factors that have caused MENA to be less successful than other regions in liberalizing trade; third, it reviews historical and more recent efforts to promote intraregional MENA trade; and, finally, it considers recent trade liberalization measures undertaken in a selected group of countries in the context of Fund arrangements.

A. The Quest for Growth and Trade Liberalization in MENA

MENA's economic performance during recent years has been characterized by a marked deterioration in the rate of real economic growth and a continuing high rate of population growth—of about 2.7 percent per annum—entailing a yearly expansion of the labor force of 3.3 percent.[3] On present trends, by the year 2010, the region will count 120 million more inhabitants, and 47 million new jobs will have to be created. Thus, in order to ensure per capita income growth, the creation of adequate employment opportunities, and the provision of needed social services, MENA countries would have to achieve annual GDP growth rates in excess of 5 percent in the next decades.[4]

These growth rates, albeit high, are not unrealizable—the Asian experience is a clear illustration in this respect—but to attain them MENA economies would have to undergo significant changes. MENA countries are at a crucial juncture. They face substantial potential opportunities: with increased liberalization in the wake of the Uruguay Round, world trade is projected to grow at more than 6 percent per year, and net flows of private capital to developing countries are increasing by almost 10 percent every year. For countries with

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[3]The population growth rate exceeds 3.5 percent a year in a number of MENA countries—for example, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE.

[4]World Bank (1995).

policies designed to make the most of such opportunities, growth prospects appear bright. Inaction, on the other hand, would lead to a further erosion of MENA's relative position vis-à-vis the rest of the world. MENA is already lagging behind: with projected real growth of 3.1 percent in 1996 and 3.8 percent in 1997, only the industrialized economies are expected to grow more slowly, and the corresponding per capita income growth rates, 1.1 percent and 1.3 percent in 1996 and 1997, respectively, would be the lowest of any region in the world.[5] If the MENA countries are to kick-start growth, bold measures are clearly called for. Moreover, a continuation of the gradualist approach to reforms of the past would undermine MENA's credibility. In the absence of a swift and comprehensive reform effort, MENA could fail to attract the needed capital inflows or to retain domestic savings. The region's financing requirements are large; partly owing to high interest payments on foreign debt in the case of many countries. Indeed, the region has not benefitted so far from the surge in private capital being channelled to emerging markets.

In recent years, endogenous growth literature has focused on a number of factors, beyond the mere accumulation of resources, that can play a decisive role in promoting increases in productivity. While recognizing the importance of traditional policies to improve human capital or foster technological progress, this literature points to evidence linking government policies that promote macroeconomic stability, price liberalization, and openness, with an enhanced growth performance. Trade openness, in particular, appears to be an important explanatory variable, and trade liberalization an indispensable component of any successful reform package, stimulating efficiency by increasing competition. Conversely, trade liberalization must be accompanied by other reforms in order to prove effective, and thus can act as a catalytic force, compelling other reforms. New growth theory highlights the impact of these necessary accompanying reforms, and the ensuing dynamic gains. For MENA, the dynamic gains of opening up, either generally or in the context of the EU agreements (see Section V below), would be very significant.[6]

The key to future growth in MENA thus lies in adopting comprehensive reforms in support of an outward-oriented strategy. More than half of MENA countries, however, derive their GDP from natural resource-based sectors, particularly oil, gas, and mining, that are being exploited at unsustainable rates. While oil exports currently account for more than two thirds of total MENA exports (and 85-95 percent of the exports of Algeria or some Gulf countries), the proven oil and gas reserves of Algeria, Oman, Egypt and Syria could be depleted in the next 20-40 years. Moreover, excessive reliance on volatile oil export receipts not only increases vulnerability to external shocks, but has led to a sharp fall in per capita income of oil producers over the past twenty years. From a record US$297 billion in 1980, the revenues of the ten main Arab oil producers plummeted to around US$92 billion in 1995—owing to the

[5]WEO (1996)

[6]El Naggar (1992 and 1996) and Zarrouk (1992).

drop in oil prices and a weakening of the U.S. dollar—while their population surged, causing a decline in their per capita income from US$1,700 in the mid-1970s to US$500 in 1995.

Clearly, in order to spur growth and meet future import needs, especially of food, oil alone cannot be relied upon over the long term. The crucial challenge is thus to promote non-oil exports, and there is ample scope for such an expansion: with about 300 million people, MENA's non-oil exports in 1995, of the order of US$66 billion, were about half the exports of Korea and one third those of Hong Kong; the openness of MENA economies lags behind competitors (see Section II above); and manufacturing exports, the major source of productivity gains, are growing more slowly than in other regions except for sub-Saharan Africa. The greatest opportunities would lie initially in the areas where MENA already enjoys a comparative advantage, mainly refined fuels, chemicals, food and animal feeds, and manufactures, especially textiles.

Are the countries of the MENA region in a position to meet such a challenge? Riordan et al. (1995) have analyzed how fast non-oil exports would have to grow for MENA countries to achieve a GDP growth rate of about 5 percent a year, allowing a yearly growth in per capita income of about 2.5 percent. For some countries—Jordan, Morocco and Tunisia—which initiated structural reforms early on, the required growth in exports would appear to be attainable in view of their recent performance. The lack of oil revenues in these countries meant that they could not delay adjustment, in contrast to the case for some oil producers. Paradoxically, these countries are in a comparatively better position than countries that enjoyed such revenues and were able to forestall reforms. For a second group—the Mashreq and the GCC countries—the required export growth rates would be double their historic values, but these rates appear attainable provided appropriate structural reforms are adopted. But many oil-producing countries would have to increase dramatically the growth rates of their non-oil exports for living standards to be maintained, let alone improved. This would require fundamental changes in economic policy, as well as the need to search for alternative sources of foreign exchange earnings.[7]

The trade reform agenda confronting MENA countries is, therefore, an ambitious one. To see it through, MENA countries will have to overcome some of the obstacles that have hampered trade liberalization to date, and to implement an array of supportive reforms, which would heighten their chance of success.

B. Factors Underlying MENA's Limited Global Integration

Until the successful implementation of more open trade policies in a number of countries in recent years, MENA countries undertook few trade liberalization efforts. Their trade systems have been characterized by high rates of protection, lack of transparency, and distortions, with the economies remaining relatively closed. The main reasons for the MENA

[7]World Bank (1995).

region's generally disappointing performance on trade reform--as well as for the limited success toward greater intraregional integration—are summarized below.

- Large revenues deriving from oil and other natural resources, as well as transfers in the form of aid, allowed many MENA countries to postpone needed reforms, including trade liberalization.

- A number of restrictive economic factors—excessive government intervention, distorted prices, lack of transparency in the regulatory environment, and nonconvertibility of the local currency—were maintained, discouraging private investment in the tradable sectors and hampering the conduct of trade.

- Excessive protectionism and distorted incentives were allowed to survive, leading to production structures inconsistent in some cases with the comparative advantages of the individual countries. This resulted in turn in limited complementarity in the production and trade structures among the countries in the region, and hence little intraregional trade.

- The lack of necessary political will to bear the short-term costs of trade liberalization, including the necessary restructuring, has been an important impediment to reforms.

- Attempts at trade liberalization within the context of formal agreements have often resorted to the inclusion of extensive provisions for exemptions and lacked a clear timeframe for implementation, thus making them virtually ineffectual and undermining credibility in the participants' commitment to reform.

- Political tensions in the region have hampered trade, and trade with Israel has been impeded by political considerations.[8]

C. Efforts to Promote Intraregional Trade

The same factors that have generally hindered trade liberalization in MENA have also adversely affected intraregional trade, though efforts to promote regional trade and economic coordination within MENA have a long tradition. In recent history, these attempts were revived by the establishment in the mid-forties of the League of Arab Nations, whose charter called for economic integration and unity among its members. The League and its members established various committees and signed treaties to coordinate economic policies, address

[8]Conflicts related to interest and security concerns have significantly undermined progress in economic cooperation—including in trade—within the region, and with the rest of the world. For details on the political economy of Arab economic cooperation see Perthes (1996). Shafik (1994) discusses the reasons underlying the disappointing progress in promoting regional cooperation and puts forward suggestions for achieving success in the future.

security issues, and promote intraregional trade. Pan-Arab sentiments and security concerns were the motivating force behind most of these efforts.

In 1964, agreement was reached on the establishment of an Arab Common Market that would eventually include all Arab countries. The initial signatories—Egypt, Iraq, Jordan, and Syria—were later joined by Libya, Mauritania, and the People's Democratic Republic of Yemen. A more encompassing agreement—the Agreement for Facilitation and Promotion of Intra-Arab Trade—was reached by all members of the Arab League in 1981. This agreement was in effect a declaration of intent to eventually eliminate tariff and nontariff trade barriers on manufactured goods, but it also provided for exceptions. In fact, all of the early trade agreements allowed for exemptions and did not set a time frame for implementation—factors that considerably undermined their effectiveness.[9]

More recent attempts have been more realistic and pragmatic. For example, frustrated by the failure of earlier attempts for Arab-wide union and cooperation attempts, three subregional grouping emerged in the eighties among countries that were able to identify direct common interests more clearly and, therefore, had the political will and commitment to coordinate and bear the short-term costs of trade liberalization and economic integration. These were the Gulf Cooperation Council (GCC)—including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and U.A.E.; the Arab Maghreb Union (AMU)—including Algeria, Libya, Mauritania, Morocco, and Tunisia; and the Arab Cooperation Council (ACC)—including Egypt, Iraq, Jordan, and Yemen. Among these three sub-groups, the GCC has been the most successful in terms of both political and economic coordination, including in trade, although progress has been slow. Little progress has been made within the framework of the AMU toward the establishment of a free trade area among AMU members and in dismantling the obstacles to intra-AMU trade. The ACC has been effectively suspended since the regional crisis of 1990-91.[10]

In the 1990s, there have been renewed attempts to promote intraregional trade among certain MENA countries within the context of existing arrangements. In 1990, for example, members of the Arab League established, through linkages with the Arab Monetary Fund, an Arab Trade Financing Program to provide trade credits for intra-Arab trade. As recently as June 1996, the heads of states of Arab countries reaffirmed in Cairo their commitment to work toward establishing a Greater Arab Free Trade Area.

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[9]For details on past and current intra-MENA trade and economic coordination see El-Imam (1990), El-Naggar (1992), Shafik (1992), Zarrouk (1992), Fischer (1993), and IMF (1995).

[10]For more details on the GCC see Christie (1986) and Sassanpour (1995). On the AMU see Abouyoub (1992), and Bell and Finaish (1994).

D. Recent Efforts at Trade Reform Under Fund Arrangements

Trade reforms have a greater chance of success if they form part of an integrated comprehensive policy package aimed at achieving non-inflationary growth, as is the case under Fund-supported programs, and/or with support from World Bank lending programs.[11] Under such programs, trade reforms are generally accompanied by the liberalization of the exchange system and greater exchange rate flexibility. In addition to restoring macroeconomic stability, great emphasis has been placed on fostering domestic price liberalization, deregulation, tax and financial sector reforms and measures geared to increase public sector efficiency and promote a favorable climate for private sector investment. Moreover, Fund-supported adjustment programs, and structural adjustment lending from the World Bank, enhance credibility and confidence in the country's commitment to reform, and as such help catalyze other forms of external financing and encourage capital inflows, including foreign direct investment. Finally, conditionality, entailing specific and binding commitments to be carried out within a specified time frame, helps to pin down trade liberalization efforts.

Conversely, trade liberalization remains a sine qua non for successful reforms, and all Fund programs for MENA countries have contained substantial trade reform measures. Such measures aim at improving allocative efficiency by allowing economic agents to base production and investment decisions on market-determined price signals, reducing anti-export bias, and spurring domestic firms to restructure in the face of foreign competition. The ensuing efficiency gains lead to improved competitiveness and increased welfare. Although several factors may be at work simultaneously—with trade reforms usually implemented as part of a comprehensive reform package—and time is required to improve resource allocation and impact efficiency and growth, evidence suggests that trade reforms have contributed to output and export growth. Together with the additional external financing that accompanies adjustment packages, trade adjustment lending has been associated with an improvement in real GDP and export growth.

In MENA as well, countries that implemented strong trade reform packages have shown better performance: Jordan, Morocco, and Tunisia, the bolder reformers, have enjoyed higher per capita real growth, and performed better in terms of employment creation, lower inflation, and faster poverty alleviation than, for instance, Egypt, Libya, and Iran. For countries with programs—generally also recipients of World Bank trade sector adjustment loans—measured ratios of imports to GDP (in current and constant prices) have risen relative to nonprogram countries, indicating the impact of both increased available financing and import liberalization.

[11]As shown by recent Latin American experience, trade liberalization is usually more successful if carried out as part of a more comprehensive adjustment and reform package. See Rodrik (1995).

Table 7. Openness and Growth

Higher Trade-to-GDP Ratios[1]

Country	Import Tariff	Weighted Average	Quantitative Restrictions	Per Capita Real GDP Growth 92-95
Jordan	50-0	19.8	5 commodities	4.2
Tunisia	63-0	31.7	8% of domestic prod.	2.1
Israel	100-0	7.2	—	2.6

Lower Trade-to-GDP Ratios

Country	Import Tariff	Weighted Average	Quantitative Restrictions	Per Capita Real GDP Growth 92-95
Yemen	30-5	13.0	yes	-0.1
Libya	100-0	—	yes	-5.2
Iran[2]	25-0	18.0	yes	0.5

Sources: IMF staff estimates and Havrylyshyn (1996a).

[1]A higher trade-to-GDP ratio would tend to imply a more outward-oriented economy (i.e., one with fewer trade restrictions).
[2]For fiscal years 1992/93-1995/96.

The above reasons may explain why, under Fund-supported programs, MENA countries have been able to embark on ambitious trade liberalization programs, and with favorable results. A number of observations can be made regarding trade reforms undertaken by MENA countries under Fund programs:

- In general, MENA countries were comparatively more closed at the outset of the reform efforts than reforming countries in other regions, and have proceeded with trade liberalization at a relatively more cautious pace than reforming Latin American countries and transition economies in Eastern Europe.[12]

- The pace of trade liberalization in MENA has picked up in recent years for program countries, though performance in individual countries has varied widely: in some countries (Morocco, Tunisia, Algeria, Jordan) substantial progress has been recorded, whereas in other countries there is still a significant unfinished agenda (Egypt) (Boxes 1 and 2).[13]

- The extent and speed of the trade reforms were tailored to the particular circumstances of each program country. However, in general, under these reform measures quantitative restrictions were replaced with tariffs to be reduced later in phases; the various surcharges and fees were amalgamated into the tariff structure; exemptions were eliminated; and the tariff structure was simplified by reducing the number of tariff bands to a few, bringing down maximum tariffs considerably, and reducing the average tariffs to moderate levels. Countries with already simplified tariff structures and moderate tariff levels are focusing on reducing the maximum and average tariffs further over the medium term.

- Progress was made in correcting misaligned exchange rates and reducing impediments to exporters, including restrictions on imported inputs. In all these countries the bias against trade, and particularly exportables, declined in part as a result of reduced import protection. Measures to promote non-oil and non-mineral exports were implemented.

- Greater progress was made in liberalizing quantitative restrictions than in reducing tariffs, though recently the emphasis has shifted toward the latter. Slower progress on tariffs can be largely attributed to the continued reliance on international trade taxes as a source of budgetary revenue for most MENA countries, where revenue from trade taxes ranges from 13 to 35 percent of total government revenue or 2.5 to 9.5 percent of GDP (Table 8). A conflict often occurs between short-term fiscal objectives and medium-term trade reform goals. However, well-designed tariff reforms may actually improve the import tax collection rate at the same time as statutory levels come down, for instance by a narrowing of exemptions (such as in Jordan, Tunisia, or Algeria). Tariff reforms have also proved more sustainable if accompanied by a restructuring of the domestic tax base: in the case of Jordan, tariff reductions were coordinated with a new General Sales Tax, while in Tunisia a VAT was introduced to compensate for the large revenue loss.

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[12]Calika and Corsepius (1994).

[13]Egypt has recently embarked on a program of economic and structural reform involving important trade liberalization measures.

Table 8. Trade Taxes in MENA Countries

(In percent)

	Import Duties (Effective)	Export Duties (Range)	Trade taxes in 1994 (% of fiscal rev.)	Trade taxes in 1994 (as % of GDP)
Oil Exporting Countries				
Algeria	15.1	0	11.0	3.2
Bahrain	5.8	0	11.8	2.8
Iran	4.0	0	3.8	1.0
Kuwait	3.8	0	2.7	0.9
Libya	8.9	50[1]	18.6	4.2
Oman	2.7	0	3.0	1.0
Qatar	...	0	2.2	0.8
Saudi Arabia	10.0	0	6.4	1.9
U.A.E.	0.01	0	1.3	0.4
Non-Oil Exporting Countries				
Djibouti	37.0	10.0	...	...
Egypt	17.3	0	13.0	4.2
Israel	1.4	0	0.7	0.2
Jordan	8.2	0	29.3	8.1
Lebanon	11.3	0	35.3	5.2
Mauritania	8.1	0-20	35	9.5
Morocco	16.2	0[3]	18.6	4.4
Sudan	13.8	5, 10	26	2.5
Syria	20.1	22.0[4]	13.2	3.0
Tunisia	17.4	1.5[5]	24.9	7.6
Yemen	8.0	0	20.0	2.8

Sources: IMF staff estimates; and Eken, Helbling, and Mazarei (1996).

[1]Excludes some specific export taxes on agricultural products.
[2]Tariffs on certain products, e.g., beverages and cars, substantially exceed the maximum tariff rate.
[3]There is a specific tax on exports of crude phosphate.
[4]Applies to cotton exports only.
[5]Export service fee.

- Even for trade reformers facing more difficult initial macroeconomic conditions, evidence indicates that more rapid reform permits faster progress in macroeconomic stabilization, particularly in fiscal adjustment, which may indicate that they were more willing, or better placed, to undertake bolder comprehensive reforms.

- The experience of the fast reformers is useful in that it signals what is achievable. Nonetheless, the extent and speed of liberalization may differ across countries for a number of reasons: resistance by protected industries, which are reluctant to see their privileges eroded; the use of trade policy measures for other objectives, such as raising fiscal revenue, managing the balance of payments, or achieving income distribution goals; and administrative and institutional bottlenecks (as in Egypt), which highlight the need to proceed in parallel with institutional reforms. Mostly, weak macroeconomic performance and conflicts between policy reform and stabilization goals have been responsible for slowing down trade liberalization (e.g., Morocco).

- Reversals in trade reforms have been nonetheless limited, and often reflected competitive pressures owing to appreciating real exchange rates, lagging domestic tax reforms, or political difficulties in resisting domestic pressures for protection. Since the use of trade instruments for nontrade objectives is a second best solution, the Fund has insisted that they be used sparingly and temporarily in emergency situations. When the reintroduction of trade restrictions has proved inevitable, the Fund has recommended across-the-board import surcharges as being least distortive—though they penalize exports in the absence of efficient compensatory schemes—and has required the phased elimination of these temporary restrictions.

Box 1. Morocco: Trade Liberalization Under Fund Arrangements

Until the early 1980s, trade policy in Morocco was aimed at (I) promoting industrialization by protecting import-substituting activities from international competition; and (ii) using trade restrictions as a means of containing external imbalance and mobilizing revenues. High tariffs and wide-ranging quantitative restrictions led to a strong anti-export bias.

A trade liberalization policy was adopted in 1983, with the following objectives: gradually reduce protection, reduce dispersion of tariffs, and replace most nontariff barriers (quotas, licensing requirements, and reference prices) with tariffs. Trade liberalization was an important element of a sequence of Fund-supported stand-by arrangements through end-March 1993.

- **Quantitative restrictions were dramatically reduced.** By early 1994, import licensing requirements applied only to a short negative list of items, most of which related to security and moral considerations.

- **The level and dispersion of tariff protection were also reduced.** Prior to the reforms, customs duties were subject to wide variations between and within sectors, with rates ranging from zero to 400 percent. The maximum customs tariff, excluding the special import tax, was reduced to 35 percent by 1993, with the exception of a few agricultural goods. The number of tariff bands was reduced from 26 to 9 by May 1992. Although most nontariff barriers were replaced with tariffs, the mean unweighted tariff, including the fiscal import tax, fell from 47 percent in 1980 to 37 percent in the early 1990s. The effective average import tax rate fell from 23.5 percent in 1980 to 20.4 percent in 1993.

- **Additional structural reforms were introduced** to eliminate barriers to exports and reduce incentive disparities between export and import-substituting activities. By early 1994, export-licensing requirements, which had multiplied in the early 1980s, had been abolished on virtually all industrial, agricultural, and mining products. Under an expanded admission scheme, both direct and indirect exporters (i.e., local suppliers to exporters) were exempt from import duties on most imported goods used in processing for re-export. Participants in this scheme were also eligible for forward foreign exchange cover available on behalf of the treasury.

- **Under the WTO**, Morocco has committed to eliminate remaining quantitative restrictions on sugar, cereals, edible oils, and to replace them with tariffs. The latter were bound at very high levels (170-230 percent). In addition, reference prices, applying to textiles and cars, will be abolished by 1998. A schedule for lowering tariffs on textiles has also been agreed.

Box 2. Tunisia: Trade Liberalization Under Fund Arrangements

Tunisia was characterized by a high level of import tariffs, with widely dispersed rates, as well as by widespread quantitative import restrictions. Import duties ranged from 5-236 percent, with an average tariff rate of 36 percent. With the aim of strengthening the outward orientation of the economy, the government embarked in 1986 on a major import liberalization program. An important objective of the program was to improve resource allocation by dismantling trade restrictions. Initially reform was supported by the Fund under a stand-by arrangement (in 1986) and subsequently under a four-year extended arrangement. In addition, the World Bank provided support under a series of structural adjustment loans, including for trade reform.

The trade reform was divided into two phases.

- In the first phase (1987-88), imports of raw materials, spare parts, semifinished products and capital goods were liberalized (with the exception of a few goods). The ratio of imported goods not subject to restrictions rose to 53 percent of total imports, from 18 percent at the outset of the program. Also in this phase, the import tax system was simplified, tariff rates reduced, and the tariff dispersion narrowed. By 1988, the minimum tariff rate amounted to 17 percent, the maximum to 43 percent, and the average to about 27 percent.

- In the second phase, after 1988, progress was slower, but further actions were taken to lift quantitative restrictions for additional categories of goods. In 1991-92, more quantitative restrictions were lifted, bringing the import liberalization ratio to 87 percent and increasing the share of domestic production subject to import competition to some 60 percent from 26 percent in 1990. At the same time, to allow domestic producers time to adjust to the increased competition, the authorities introduced in 1991, and broadened in subsequent years, temporary compensatory duties (DCPs since 1994) ranging between 0-30 percent for some of the liberalized products.

In 1994, a new Foreign Trade Law was adopted that introduced a negative list. According to official estimates, the adoption of this list implied a further reduction of the share of domestic production protected by QRs to 17 percent by end-1994. In late 1995, the authorities abolished another tranche of QRs, mainly textile products, covering 9 percent of domestic production. More recently, in June 1996, several agricultural products were also eliminated from the list. Moreover, in April 1996, the DCPs were harmonized at 10 percent.

IV. GATT, THE URUGUAY ROUND, AND THE WTO

A. Introduction

The MENA countries are at a crucial juncture in terms of their options for addressing the obstacles to trade liberalization and adjustment more generally. The impetus to global trade, and therefore to economic growth, presented by the conclusion of the Uruguay Round and the establishment of the World Trade Organization (WTO), as well as the launching of the Mediterranean Basin Initiative by the European Union to support policy reform in many of the MENA countries, offer significant opportunities for the region. Countries in MENA must either embrace the measures necessary to overcome the past protectionist tendencies or risk being marginalized further in the world economy. The implications for the MENA countries of these two multilateral trade initiatives are addressed in this and the following sections.

Since 1948, the international trading system has been guided by the rules and procedures agreed to by the signatories to the General Agreement on Tariffs and Trade (GATT). The basic principles of GATT set out rules governing trade between the signatories, introduced a forum for negotiations, and established mechanisms for resolving disputes. The main objectives of these principles were the reduction of trade barriers and the prevention of discrimination in trade. The process for achieving these objectives has been encompassed in a succession of rounds of trade negotiations aimed at reducing tariffs and other barriers to trade, as well as in the introduction of the Most Favored Nation (MFN) principle. The main success of the various GATT rounds (until the most recent) was a reduction in tariffs on manufactures.

The most recent round of trade negotiations—the Uruguay Round—was initiated in 1986 and concluded in April 1994. Under the initial GATT negotiating rounds, many developing countries obtained special and differential treatment from the industrial countries that did not require reciprocal tariff cuts. However, recognizing the gains to be reaped from opening their own economies, developing countries participated more actively in the latest Round—the most comprehensive of the eight GATT rounds.

Estimates of the worldwide income generating effects of the Uruguay Round vary, with more recent studies projecting these benefits to total around $170-190 billion a year, of which between a quarter and a half of these gains would accrue to the developing world.[14] The Round was considerably more successful than earlier negotiating rounds in broadening the scope of trade liberalization to cover agriculture and services, and new aspects of trade—such as trade-related property rights (TRIPs) and trade-related investment measures (TRIMs). In addition, the General Agreement on Trade in Services (GATS) represented a key step in

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[14]For various estimates of the global gains from the liberalization measures incorporated under the Uruguay Round, see Goldin, Knudsen, and van der Mensbrugghe (1993); Harrison, Rutherford and Tarr (1995); and François, McDonald, and Nordstrom (1995).

expanding the coverage of trade liberalization to an area not covered before, even though the Round did not incorporate a reduction in protectionism in this area. The TRIPs agreement is expected to have a more direct effect, and will over time increase the protection of intellectual property rights. The World Trade Organization was established by the Uruguay Round as a successor to the GATT. It will have a much broader mandate than its predecessor, with important and enhanced responsibilities relating to dispute settlement (Box 3).

Box 3. The World Trade Organization

The World Trade Organization, which initiated operations on January 1, 1995, is an institutional framework encompassing the multilateral trade agreements (dealing with goods, services, and intellectual property) and legal instruments (covering dispute settlement, as well as trade policy review mechanisms) included under the Uruguay Round of trade negotiations.

The WTO has been given the following five principal responsibilities:

- to facilitate implementation of the Uruguay Round;
- to provide a forum for multilateral trade negotiations and a framework for the implementation of their results;
- to administer the dispute settlement procedures;
- to administer the trade policy review mechanism; and
- to cooperate with the IMF and the World Bank.

Thus far, 10 MENA countries have joined the WTO: Bahrain, Djibouti, Egypt, Israel, Kuwait, Mauritania, Morocco, Qatar, Tunisia and the United Arab Emirates. Four additional MENA countries have requested WTO membership: Algeria, Jordan, Saudi Arabia, and Sudan. (The accession process involves the examination of a country's trade policies based on a memorandum submitted by the application, bilateral negotiations on market access in goods and services, and drafting of a report of the working party and agreement on a Protocol of Accession.) Two countries—Iran and Oman—have requested observer status.

More generally, the Round is expected to bring a number of advantages to developing countries.

- It will increase transparency and reinforce credibility in the world trading system, thus facilitating greater stability in the world economy, which in turn should promote trade and enhance growth prospects.

- By reducing tariff and non-tariff measures, greater market access for agricultural and industrial goods by developing countries will be ensured. However, the positive impact of trade liberalization will be offset to some extent by the loss of preferential access to selected markets that some countries have enjoyed;

- Individual country commitments to liberalize trade, made in an international forum, could help to anchor policy reform, thereby enabling the authorities to resist pressures from domestic interest groups and limiting the chance of backsliding. This will also increase the likelihood that liberalization measures (as well as supporting reforms in other areas) are taken at a more accelerated pace than otherwise.

B. The Uruguay Round and MENA

The Uruguay Round incorporates significant progress in removing nontariff measures facing MENA exporters, especially in agriculture, and textiles and clothing. However, elements of the Round could have adverse consequences for MENA, particularly in the short term. The MFN tariff cuts incorporated in the Round will reduce preference margins that some MENA countries have enjoyed with the European Union, under the Mediterranean Agreements, as well as under other preferential trade agreements.

A number of studies have been carried out on the impact of the Round on MENA countries. In general, these studies conclude that there will be some important initial losses for MENA. However, these losses can be mitigated to the extent that MENA countries themselves undertake important domestic policy reforms, leading eventually to the development of more efficient productive capacity as well as a more diversified economic and trade structure.

- **Harrison, Rutherford and Tarr** (1995), using a multiregional trade model, find that the impact of the Uruguay Round measures on MENA could be negative, reflecting the expected rise in food prices and the "erosion of rents" created by the MFA. Over time, however, the region is expected to benefit from trade liberalization, increasing aggregate welfare by up to US$1.3 billion a year (without factoring in adjustment costs). The extent of the potential benefits will depend on the policy response of individual countries in the region, particularly their effort to open their own markets.

- **Diwan, Yang and Wang** (1995) use a computable general equilibrium (CGE) model to conclude that the MENA region will experience a social welfare loss of some US$2.6 billion a year (or 0.45 percent of its 1992 GDP)—much larger in relative terms than other regions they examine. They attribute this outcome to: higher food prices; greater competition in the textile and clothing sector, stemming from the dismantling of the MFA; and higher prices for capital and skill-intensive manufactured goods—an important group of imports for the region. Prices for the main export of the region—minerals and energy—are expected to remain constant. (The losses would be even higher if the MENA countries do not participate EU efforts to establish a trading bloc incorporating Eastern Europe, the FSU, and Turkey.) They note that the best way for MENA countries to minimize these losses is to commit to trade liberalization and much needed domestic policy reforms.

- **Yeats** (1996) estimates that the Middle East could experience a net increase in exports of approximately US$800-US$900 million a year as a result of Uruguay Round tariff cuts—especially in agriculture and, textiles and clothing.[15] He notes that the projected overall gains are small, because of the erosion of tariff preferences Middle East countries enjoy in the member countries of the Organization for Economic Cooperation and Development. He also points out that petroleum exports—the major export of the region—generally face zero or very low tariffs, and will therefore not be affected by the UR.

Ten of the 23 MENA countries are members of the WTO and have made commitments under the Uruguay Round. Of this group, most countries have bound tariffs (i.e., made commitments to maintain tariffs within a maximum tariff rate) at a higher rate than the level applied prior to the UR—a somewhat disappointing development.

As for the GATS, Algeria, Bahrain, Egypt, Israel, Kuwait, Morocco, and Tunisia are already participants, and a number of other MENA countries are in the process of submitting commitments. Thus far, the MENA countries have not made particularly noteworthy commitments under the agreement: the most substantial commitments were made in the tourism sector, but even these were subject to an array of qualifications and exemptions (Hoekman and Primo Braga, 1995). This, despite the fact that the MENA countries stand to reap significant benefits from more open trade in services, not only in terms of greater international market access for domestic service suppliers, but—perhaps more important—through greater access by the domestic economy to efficient services, such as financial services, communication, transportation, and insurance. Such access would enhance competitiveness and productivity in other sectors of the economy and would facilitate the development of the private sector—an objective of virtually all MENA countries. More transparency in these areas would encourage foreign direct investment, domestic investment, and the return of domestic capital invested abroad (as in the case of the GCC).

In sum, the commitments made by MENA countries under the UR are not particularly ambitious. On average, the level and degree of liberalization encompassed within their commitments are less than that of the developing countries as a group. High average rates of protection would remain after the UR is fully implemented.

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[15]Yeats' analysis is based on a slightly broader grouping than the MENA countries. In addition to the MENA countries, he includes Cyprus and Turkey in his analysis. However, the broad orders of magnitude of gains and losses for the region provide useful comparisons for this paper.

C. Sectoral trade reforms and the implications for MENA

Manufacturing

MENA exports of industrial goods are concentrated in three sub-sectors: metals (Algeria, Bahrain, Egypt, Mauritania, Qatar, and the U.A.E.); chemicals, largely petrochemicals (the GCC, and Algeria, Jordan, Libya, Morocco, Syria and Tunisia); and textiles and clothing (Egypt, Morocco, Syria, Tunisia, and the U.A.E.). In addition, fish exports make an important contribution to Mauritania's economy. While all of these countries stand to gain from the progress achieved in tariff reduction (Box 4), some countries—particularly the North African countries and Israel—that have benefitted from preferential access to the EU for their industrial products exports, will be more adversely affected than the other MENA countries to liberalization measures incorporated under the Round. Furthermore, in view of the relatively limited extent of protection applied to crude petrochemical products, this category of MENA exports is unlikely to be affected by measures incorporated in the Round.

With respect to trade in textiles and clothing, in view of the significant room for discretion under the agreement to eliminate the Multifibre Agreement, it is particularly difficult to assess the implications of this element of the Round on the MENA countries. While Egypt is the only MENA country that currently participates in the MFA (Israel was a participant until 1986), textile and clothing exports account for a relatively large proportion of total exports in a number of other countries in the region—in Morocco, Tunisia, and Syria they exceed 50 percent of total manufacturing exports. These countries are subject to some extent to nontariff barriers—in the form of quotas, monitoring, voluntary export restraints, and antidumping measures—in both the EU and US markets and thus stand to benefit from the liberalization of this sector. However, Egypt, as a participant of the MFA, currently faces the toughest barriers to trade, including binding quotas within the framework of the MFA and will have the most to gain from the progress achieved under the Round.

On the other hand, with the dismantling of trade barriers under the MFA, the textile and clothing industries in MENA countries will be open to greater international competition. The extent to which the potential gains can be realized will therefore depend on their ability to improve their competitiveness relative to other producers. The overall macroeconomic policy environment, as well as structural reform measures, will be important determinants of these countries' effectiveness in limiting inflation, and reducing labor, transport and capital costs, relative to those of major competitors.

Box 4 . Uruguay Round: Liberalization of Manufacturing

Significant progress was made under the Round in reducing the protection afforded to the manufacturing sector. Tariffs on manufactured imports into industrial countries were reduced from a trade-weighted average of 6.3 percent to 3.8 percent—a cut to be phased in over five years (Martin and Winters, 1995). Tariff escalation in industrial countries—whereby tariff rates increase with the degree of processing involved—was also addressed with some success under the Round. Tariff escalation has been an important concern of developing countries as it discourages the export of products with a higher value-added. Notable progress was made in addressing the proliferation of non-tariff barriers, including most significantly those incorporated under the Multifibre Arrangement (MFA)—a set of bilateral agreements under a multilateral framework that imposes quotas on textiles and clothing exports from developing countries to participating industrial countries, as discussed below.

Textiles and clothing: The MFA was intended to protect temporarily the industrial countries' domestic textile and clothing industries from imported goods from the developing world and to provide for the orderly allocation of developing country exports among industrial countries' markets. The intention was to gradually reduce, and eventually eliminate, the protection afforded to the industrial countries. However, the MFA was virtually permanent and was renewed periodically. The MFA has 40 participants and covers 80 percent of world textiles and clothing exports, with some 100 bilateral restraint agreements.[1]

Under the Uruguay Round, the developing countries took a firm stand on the need to apply GATT rules also to trade in textiles and clothing. As a result, for the first time under the GATT, the Round incorporated important measures aimed at freeing trade in this sector. It was agreed that the MFA would be gradually eliminated over 10 years, although the provisions allow for the liberalization measures to be substantially backloaded. There will be four phases of liberalization, and within each phase there is much discretion on the part of importing countries on the extent and form of market opening.

[1]See Kirmani, Chanda and Shiells (1996) for a detailed discussion of the MFA.

Agriculture

The impact of the commitments for trade liberalization in agriculture on the MENA region are difficult to estimate (Box 5). With the reduction of food export subsidies implicit in the UR commitments, food prices for many products—including grains, meat, milk, and sugar—would be expected to increase (see Goldin, Knudsen, and van der Mensbrugghe (1993)). The impact on MENA countries would depend largely on their balance of trade in agricultural products. As discussed earlier, the region as a whole is a net food importer and would thus tend to be adversely affected by the agricultural import price increase. However, assuming that the agricultural producers of the region—for example, the Maghreb countries, Egypt, and Israel—were to adopt appropriate policies to ensure the competitiveness of their agricultural output in an increasingly open trading environment, there is potential for further income-generating effects for those countries.

Box 5. Uruguay Round: Liberalization of Agriculture

The Uruguay Round was the first of the GATT negotiations to address agricultural trade policies in a comprehensive manner. Under the Round, all nontariff barriers were converted to tariffs and virtually all tariff lines were subject to bindings. The Round provided for the reduction of these tariffs by 36 percent over six years (24 percent over 10 years for developing countries), with a minimum tariff cut of 15 percent for each product (10 percent for developing countries). However, many countries made commitments for bindings that do not actually involve liberalization compared with earlier nontariff equivalents. Nevertheless, important progress was made to the extent that the agreement provides for greater transparency and sets a framework for future negotiations on liberalization in this sector.

Services

The share of services in total exports of the MENA countries has increased in the past decade, and represents a relatively large share in a number of countries. For example, tourism and migratory workers' income contribute importantly to the export receipts of Egypt, Jordan, Morocco, and Tunisia (Table 9). As noted above, however, the MENA countries have generally not made noteworthy commitments to open their service sectors to foreign competition. Substantive commitments would not only encourage the development of more efficient domestic services, it would enhance the productivity of other export sectors.

In sum, the Uruguay Round has potentially large income-enhancing effects for the world, and represents an important stimulus to multilateral trade liberalization (Box 6). However, the benefits of the Round to the MENA region are difficult to quantify, and differ among the individual countries in the region—depending on the commitments made under the Round, the structure of their economies, and the extent to which any advantages will be offset by the erosion of preferential trading arrangements. It is clear that in order to reap the most benefits from the Round, the MENA countries will need to use the multilateral framework to "lock in " trade liberalization in all sectors. In this regard, the commitments made by the MENA countries under the Round were not particularly ambitious, and in many cases do not reflect a reduction in pre-existing tariff levels. In addition, more than 40 percent of the countries in the region have yet to demonstrate their resolution to pursue market-opening measures by joining the WTO.

Box 6. Uruguay Round: Liberalization of Services (GATS)

A major outcome of the Uruguay Round was the General Agreement on Trade in Services (GATS)—representing the establishment of disciplines in a completely new area. Services encompass a broad range of activities—from transportation, travel, and other private services—such as brokerage, communication, nonmerchandise insurance, leasing and renting of equipment, technical and professional services, as well as royalties and license fees related to intellectual property (Hoekman and Primo Braga, 1996). In general, trade in services is restricted through regulations rather than through tariffs. The GATS aims to ensure the transparency of domestic regulations related to services, and to provide for market access and national treatment. While all service sectors are potentially covered under the agreement, countries making commitments may choose those sectors to which they wish to ensure market access and national treatment. Participants may also provide for exemptions and qualifications. Thus, the GATS negotiations were focused on all-or-nothing commitments to liberalize particular services sectors, modes of supply, and protective instruments. Unfortunately, while progress was made in terms of establishing a framework for liberalizing trade in services, the commitments made by participants imply a very limited move toward more open trade in this area. Looking at the positive side, however, the existence of a framework for trade in services provides a starting point for future negotiations in this area, and at a minimum limits the extent of backsliding for those countries that have made commitments.

Policy-makers in the region are increasingly recognizing the need for greater integration in the world economy if the region is to achieve higher levels of economic growth and meet the demands presented by an increasing population and labor force. However, they will need to reinforce the credibility of their commitment to trade reform and demonstrate their willingness to put aside the gradualist approach of past reform efforts by committing to a schedule of bound tariffs and other liberalization measures within the legal and transparent framework provided by the WTO. The trade reform efforts will also need to be supported by a broad range of other structural and macroeconomic policy reforms necessary to improve the international competitiveness of their domestic production. Furthermore, MENA countries should look at other opportunities, as some already have, to offset some of the potential adverse effects of the Uruguay Round as well as further reinforce ongoing reform efforts by embarking on trade liberalization in the context of other multilateral fora, including under the EU-Mediterranean Initiative, and of regional trade initiatives.

Table 9. MENA Region: Exports of Services, 1990–95

(In percent of total exports of goods and services)

	1990	1991	1992	1993	1994	1995
All MENA countries	17.2	17.8	18.6	19.0	18.8	19.1
Oil exporting MENA countries	11.1	11.1	10.5	10.2	9.0	8.7
Algeria	3.5	3.7	5.0	5.5	7.5	8.0
Bahrain	18.9	21.0	26.6	25.1	26.8	25.8
Iran, Islamic Rep. of	4.4	4.5	4.1	5.2	3.0	2.7
Kuwait	16.0	53.1	18.6	10.8	11.4	12.3
Libya	0.8	0.9	3.2	1.7	4.1	6.2
Oman	0.7	0.9	0.5	0.6	1.1	1.0
Qatar	1.4	4.2	0.8	2.3	4.0	0.2
Saudi Arabia	21.9	19.7	18.0	18.5	15.5	13.9
United Arab Emirates	0.0	0.0	0.0	0.0	0.0	0.0
Non–oil exporting MENA countries	35.2	36.8	40.7	40.5	39.9	40.0
Djibouti	39.0	69.8	73.6	69.4	73.8	82.9
Egypt	62.1	65.4	68.8	69.1	68.9	68.3
Israel	27.2	27.9	30.5	29.2	28.2	29.0
Jordan	48.0	43.7	54.3	55.8	52.3	50.0
Lebanon	53.0	60.4	60.3	65.8	62.5	64.5
Mauritania	10.8	12.7	12.5	7.9	8.9	11.8
Morocco	34.6	31.0	39.1	40.4	39.8	37.9
Somalia	35.9	33.1	31.8	29.6	27.1	25.2
Sudan	26.1	16.6	10.3	15.2	18.8	16.5
Syrian Arab Rep.	10.7	11.7	18.2	19.9	24.9	28.6
Tunisia	32.3	27.4	32.8	35.0	33.0	32.4
Yemen,Rep. of	10.3	15.9	15.6	14.9	7.7	8.2

Source: IMF, World Economic Outlook, May 1996.

V. THE EU-MEDITERRANEAN INITIATIVE

A. Introduction

The economic and trade relations between the MENA countries and the EU, their major trading partner, are being redefined in response to a number of new developments. First, the EU itself and its role are changing, with an expansion of its membership, the signing of association agreements with Central and Eastern European (CEE) countries; and a customs union with Turkey. As a result, MENA countries are facing increased competition from countries which are also geographically close to the EU. Second, the ongoing multilateral liberalization in trade and services in the framework of the WTO and the GATS will lead to a marked erosion of the preferences that MENA countries presently enjoy in the EU market, inter alia due to the phase-out of the Multifibre Agreement (MFA). To be able to compete under these new circumstances, MENA countries will not only have to rethink their trade strategy, but to implement more far-reaching liberalization, privatization and deregulation.

In this context, the EU has launched a new Mediterranean strategy, with agreements that seek to strengthen political ties and create a free-trade Euro-Mediterranean area with Southern Mediterranean Rim (SMR) countries over 12 years. Increased aid and technical assistance from the EU will support the needed structural reforms.[16] Agreements have recently been concluded with Tunisia, Morocco and Israel, and are currently being negotiated with Algeria, Egypt, Jordan and Lebanon. This new generation of agreements will supersede the previous ones, dating from the 197Os, which provided duty-free access to EU markets for most industrial goods, and preferential access for agricultural commodities, while signatory MENA countries applied MFN treatment to EU goods. Under the earlier agreements, financial assistance from the EU was channelled through individual country protocols renewable every five years.

Under the new EU Mediterranean strategy, the envelope amount of assistance for all SMR countries has been increased: the EU has allocated ECU 4.7 billion in grants over 1996-99 for structural adjustment in the region, with an equivalent amount in loans from the European Investment Bank (EIB) channeled to specific projects. About half of the funds are earmarked to prepare for free trade (private sector development, trade-promoting schemes, infrastructure), with the remainder devoted to poverty alleviation, rural development and environmental conservation. This kind of financial assistance would help alleviate short-term costs of implementing the agreements. Moreover, as an additional incentive to reform, individual country allocations are not predetermined as in the past, but will be partly determined on the basis of the pace of reform, with the likelihood that larger shares will go to the fastest reformers.

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[16]The main principles of the strategy were stated in the Barcelona Declaration of November 1995.

The Euro-Mediterranean agreements seek to attain a number of objectives: intensify the political dialogue; achieve reciprocal free trade between the MENA countries involved and the EU in most manufactured goods; grant preferential and reciprocal access for some agricultural products at a later stage; establish conditions for the liberalization of the right of establishment and the supply of services; facilitate free capital flows; encourage SMR countries to take on board a wide range of trade-related EU regulations (customs, standards, competition, protection of intellectual property rights, etc.); and increase economic, social and cultural cooperation. The envisaged financial and technical support from the EU would facilitate the implementation of these measures. An eventual accession of SMR countries to the EU is not contemplated, however, in contrast with the CEE countries.

B. The Main Features of the Euro-Mediterranean Agreements

The agreements being signed or negotiated with the SMR countries share the following objectives:

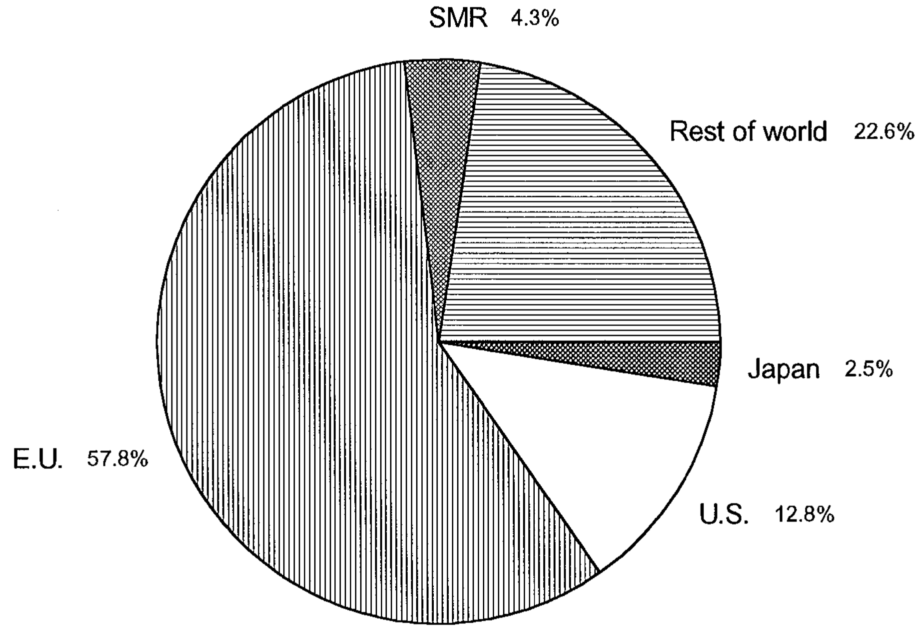
- **Progressive elimination of all tariffs on industrial goods** over 12 years. The EU is the major trading partner of SMR countries (accounting for 57.8 percent of the exports and 53.1 percent of imports, Chart 4), and also the major industrial trading partner, and most SMR industrial exports already received preferential customs treatment both by virtue of the Generalized System of Preferences (GSP) and of the existing bilateral agreements. Thus, in this area, SMR countries appear to gain little from the EU agreements in the immediate future: most of their industrial goods exports already enter the EU with few or no restrictions, whereas they will have to dismantle the protection on their industrial goods imports from the EU, heavily sheltered at present. Nevertheless, maintaining the status quo would lead to a relative deterioration in the position of SMR countries in the EU market, owing to the impact of the Uruguay round, which will erode the margin of preference granted to SMR exports by the preferential scheme and phase out the quotas on the imports of textile and clothing products—an important export category for many SMR countries. [17]

- **Gradual and limited trade liberalization for agricultural products**, with substantive discussions only by the year 2000. SMR agricultural exports to the EU will not receive more favorable treatment in the short run, although in some cases (Tunisia) some additional preferences are envisaged from the outset. As mentioned, the new WTO Agreement on Agriculture (AA) will have important repercussions on agricultural trade of the SMR countries with the EU. First, many SMR countries depend heavily on food imports, the prices of which are expected to increase following the full implementation of the Uruguay round. Second, SMR countries have undertaken or will have to undertake new commitments under

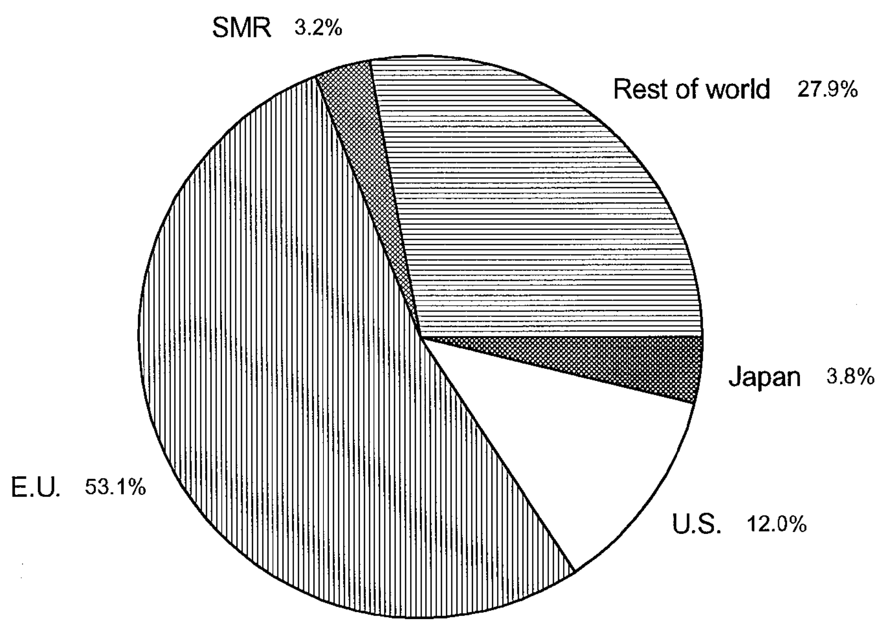
[17] In the agreements with Tunisia and Morocco, there is no special treatment regarding textiles nor a more rapid elimination of export quotas than agreed under the GATT, as was the case for CEE countries.

Chart 4
SMR: Direction of Trade
(In percent; 1990-95 averages)

Destination of Exports



Sources of Imports



Source: IMF, Direction of Trade.

EU agreements that are consistent with those agreed under the Uruguay Round, including the requirement to convert all non-tariff measures into customs duties. [18]

- **Measures to liberalize services**. The previous Euro-Mediterranean agreements did not address the issue of services and, of the new agreements, only the one with Lebanon proposes a liberalization of services without a reference to the GATS protective clauses. This omission is disappointing, particularly given the already weak commitment to services liberalization of SMR countries in the context of the WTO, with scant use of GATS bindings, and given that trade in services could become an area of dynamic growth and potential comparative advantage (especially in banking, insurance and shipping) for SMR countries. In this light, the EU agreements could provide a real opportunity to signal serious policy commitment, by setting a concrete transition path to achieve a liberal environment. Although the small size of SMR firms could be a potent barrier to entry in the EU market, "reciprocity" concerns are not a good rationale for abstaining from making commitments in this area.[19]

- **Measures to liberalize the right of establishment** are being sought in the draft agreement with Lebanon, well beyond what is contemplated in other Euro-Mediterranean agreements, which refer only to WTO commitments. As in the case of services, by liberalizing the right of establishment, a country signals that it is open to foreign direct investment (FDI) and willing to bind this pledge, thus increasing the incentive to foreign firms to establish themselves, with the ensuing concomitant financial and technology transfers.

- **Adoption of a wide range of trade-related EU regulations**. Harmonization of rules and regulations would facilitate trade. Two important areas where harmonization is envisaged are:

> — **Competition policy**. Since competition policy plays a key role, the agreements envisage the adoption and application of the basic EU competition rules, a progressive elimination of non-tariff barriers, and harmonization of safeguard and anti-dumping provisions within five years. During the transition period, GATT rules with respect to countervailing of subsidies would apply, and WTO-consistent antidumping legislation would remain applicable in most cases. State aid for disadvantaged regions would have to be compatible with EU competition rules—for instance, in the case of Tunisia it is allowed for the whole territory for five years.

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[18]Transitory and safeguard measures are built into some of the agreements: the possibility of suspending the liberalization calendar for some products in case of serious difficulties; exceptional measures in certain cases for three years beyond the transitory period; and the possibility of modifying the agreement if the agricultural policy or calendar are modified.

[19]Hoekman and Djankov (1995).

— **Intellectual property rights**. EU-SMR agreements generally refer to commitments of the Agreement on Trade Related Aspects of Intellectual Property rights (TRIPs). For non-WTO members, the legal framework would have to comply with WTO requirements both in terms of scope and enforcement. Due to concerns about enforcement capacity, a transition period is envisaged.

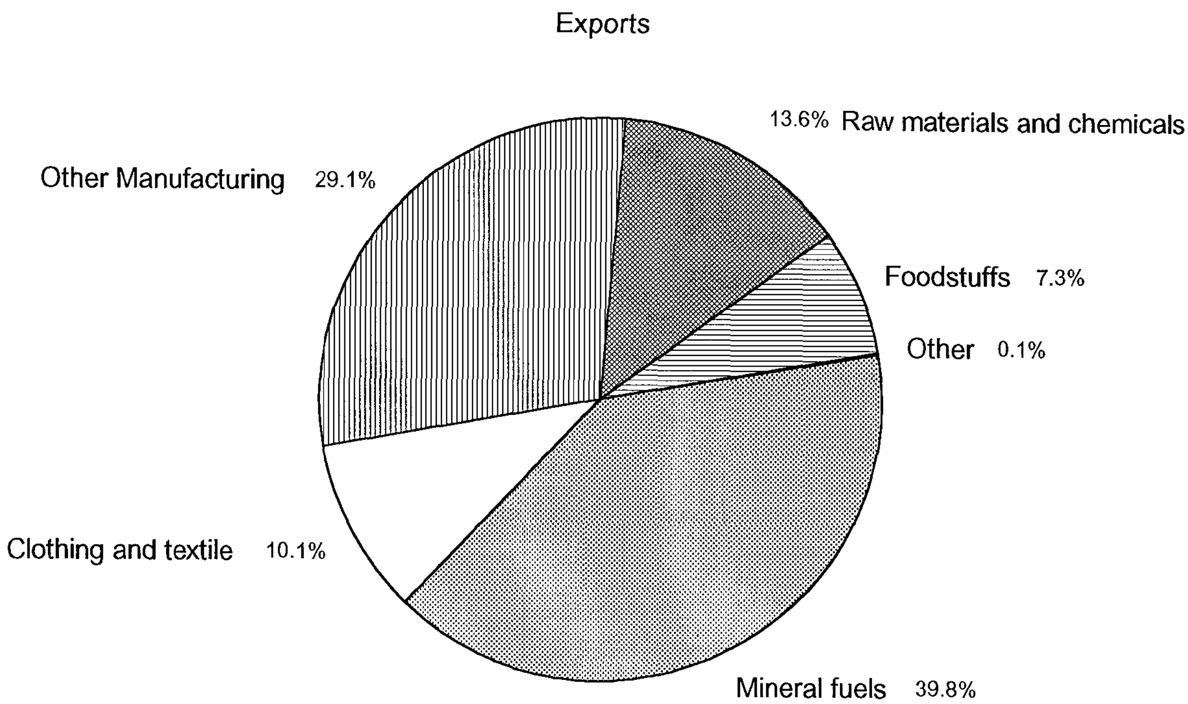
C. Economic Implications for SMR Countries: Costs and Benefits

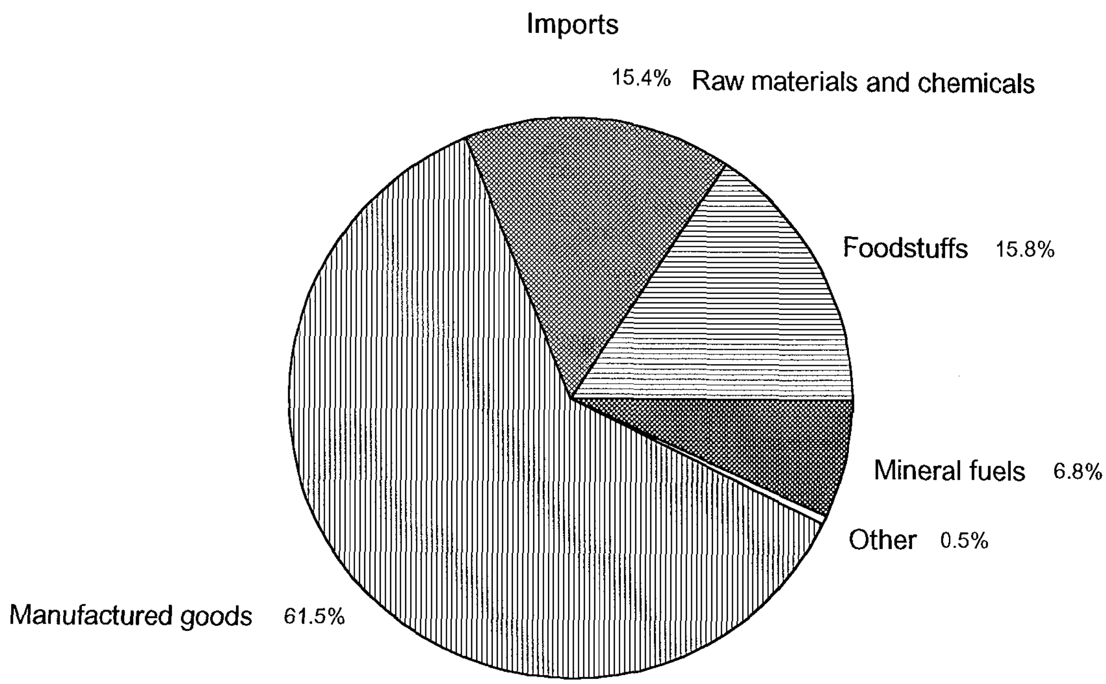
Overall, the new agreements are likely to be beneficial in the long run for the MENA countries involved, but there will be costs in the short to medium term. Several studies have analyzed the welfare implications of the trade agreements for a number of SMR countries that have already concluded agreements, attempting to quantify the economic impact. The welfare gains could be substantial. Rutherford, Rutström and Tarr (1995) estimate that Morocco and Tunisia would experience welfare gains equivalent to 1.5 percent and 4.7 percent of GDP per year, respectively. Most of the benefits would stem not from the reduction in tariff and nontariff barriers, but from the gains in competitiveness that would result from the harmonization of standards and the reduction in trading costs. Furthermore, with these gains persisting every year, the compounded effect over time could be sizeable. Even more striking, the benefits would increase considerably in the event of MFN liberalization on a multilateral basis—to 2.5 percent of GDP a year for Morocco and 5.3 percent of GDP a year for Tunisia, for example—with relatively little additional cost.

A number of short-run costs are involved, however. First, there will be substantial fiscal revenue losses, due to the importance of trade taxes in total fiscal revenue (Table 8 and Section III.4) and the dominant position of the EU in their trade. Moreover, manufactured goods with relatively high tariffs constitute a large share of imports from the EU, so the loss in customs revenue would be comparatively larger (Chart 5). The potential revenue loss could be compounded in the event of substantial trade diversion. The upfront loss of revenue has been considerable in Tunisia and Morocco, entailing the need to introduce a new tax or raise rates on existing taxes to make up for this revenue loss. This is a problem that negotiating countries are having to face, given the objective of avoiding an increase in the fiscal deficit—particularly important in view of the large existing fiscal imbalances in some cases.

A related issue is that the revenue loss in the early phases would vary depending on the phasing of the liberalization measures and the products affected. In the case of Tunisia, liberalization of intermediate inputs and capital goods—subject to low tariffs to start with--was frontloaded, and liberalization of consumer goods was backloaded. The strategy of starting with products that have the lowest tariffs when eliminating tariffs preferentially against some of the EU imports is designed to reduce the fiscal adjustment costs. However, this strategy may entail sizable welfare losses because the sectors receiving the highest protection at the outset would receive even higher protection in relative terms. The effective rate of protection would increase during the first part of the transition as industries would

Chart 5
SMR: Composition of Trade
(In percent; 1990-94 averages)





Source: United Nations, Trade Analysis and Reporting System.

benefit from tariff reductions on their inputs while continuing to enjoy protection on their products. Despite the benefit of lowering the average protection level in the economy, the greater dispersion of tariffs combined with the trade diversion costs would reduce welfare. Insofar as the increase in effective protection during the transition period would lead to inefficient investment and non-adjustment, it might lead to pressures in the future to resist market opening or impose safeguard actions. Liberalizing the import of goods competing with domestic production only five years after the entry into force of the agreement would accentuate these problems. A preferable strategy would be to reduce the highest tariffs first. Thus, choosing a more appropriate sequencing from an efficiency point of view may become more difficult due to the size of the fiscal revenue loss. [20]

Second, costs arising from the loss of preferential trade arrangements and the ensuing trade diversion would be comparatively high given the share of the EU in SMR trade (Chart 4). Losses associated with trade diversion would be minimized by liberalizing simultaneously vis-à-vis the rest of the world in the equally credible and more efficient framework of the WTO. The fact is, however, that SMR countries did not use the Uruguay Round to make substantial commitments to liberalize trade, and the EU agreements may have provided an incentive for trade liberalization that might not have taken place otherwise.

Third, trade liberalization implies that some depreciation might be needed to restore equilibrium in the balance of payments. In the absence of the required exchange rate adjustment, the trade deficit would increase, necessitating depreciation later or a reversal of the liberalization.

Finally, there will be short-term adjustment costs both for labor and capital as competition would increase in some industries and factors of production would have to be reallocated or restructured. In the case of SMR countries, with generally high unemployment rates and extensive overmanning in state-owned enterprises, the loss of employment that the EU agreements might generate could create social pressures unless measures are taken to put in place an effective safety net and to finance restructuring and retraining.

However, an agreement with the EU could entail sufficient benefits to offset the short-run costs. First, there would be opportunities for deep integration, as the EU association agreements cover a range of issues going well beyond trade. Critics tend to focus narrowly on trade, where the advantages to the SMR countries appear prima facie limited. But benefits would not only arise from reducing tariffs and non-tariff barriers, there are additional dimensions: liberalization could extend to services; technological transfers would improve product quality; the harmonization of product quality standards would render products more

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[20]Panagariya (1995) and Hoekman and Djankov (1995) argue that multilateral liberalization, the superior welfare option, could prove more difficult due to the revenue loss entailed by liberalization vis-à-vis the EU and the pressures by domestic and EU firms to maintain sheltered home markets, pressures that could be heightened by erroneous sequencing.

marketable in the EU; there would be increased efficiency in trading, due to improvements in telecommunications and transport; and the harmonization of regulatory regimes and administrative requirements with the EU would facilitate trade, promote investment and enhance competition in domestic markets. Moreover, with the agreement, increased financial and technical assistance would be forthcoming, facilitating a "mise à niveau" of the SMR countries productive base.

Second, the association agreements would contribute to "lock in" reforms, anchor expectations and enhance credibility, thus attracting more FDI. The credibility derives from the formal nature of the treaties and the availability of financial and technical assistance from the EU to help implement the needed structural reforms. Credibility would also be enhanced by undertaking commitments going beyond minimum WTO requirements in the areas of investment, services, or increasing security of market access. There are very strong arguments in favor of such an approach: in many sectors, particularly in services, foreign direct investment through the establishment of foreign firms has proved to be the most direct method of enhancing competition and efficiency.

Third, the agreements would require a rethinking of numerous aspects of the policy framework, since companion reforms to trade liberalization are indispensable if the liberalization is to succeed. The experience of other countries shows that those that pursue reforms more aggressively reap greater benefits. Reforms must be broad-based and keep pace with those in other countries, otherwise it may be possible to lose not only in relative but in absolute terms. An important factor constraining policy reform in a number of MENA countries has been the absence of political support for opening up the economy and the perception that rapid liberalization might bring about political unrest, thus leading to a preference for gradual reform. But in the present global environment reform efforts must be accelerated. Closer relations with the EU may help overcome some of the political constraints, while providing financial assistance that would help to face the short-term adjustment costs of liberalization, costs that would have to be incurred anyway in the pursuit of an outward-oriented strategy. Moreover, a free-trade agreement can provide the stimulus and discipline to speed up the pace of reform.

Fourth, the agreements could be a first step toward greater unilateral trade liberalization. As discussed above, the welfare gains for SMR countries of free trade with the EU are substantial, but gains would be considerably larger if liberalization were conducted with the rest of the world. To the extent that the EU agreements form part of a strategy to liberalize trade more generally, possible welfare losses would be reduced. There are other reasons to open up more generally. Since intra-MENA trade is limited, the set of Euro-Med agreements would provide an incentive for a "hub and wheel" pattern of trade—where there is an incentive for firms to set up in the EU to profit from the free market access to all other partners, while deterring EU firms from investing in SMR countries. Only intra-SMR liberalization could counter that risk effectively. Furthermore, SMR exports are already too concentrated in Europe, a market which is growing more slowly than the rest of the world, particularly Asia. It is therefore important that, concurrently, external barriers to trade and FDI vis-à-vis other countries be reduced as well.

In sum, despite all the potential benefits ensuing from the Euro-Mediterranean initiative, important challenges have to be overcome for it to result in higher rates of growth of per capita income and exports. By itself, the initiative will not solve all problems—it only offers opportunities. Most important, SMR countries themselves have to take measures to minimize the transition costs. First, supportive structural reforms are essential. Second, liberalization with the rest of the world would contribute to reduce possible welfare losses. Third, the countries involved should try to enter into FTAs among themselves in order to avoid the hub-and-spoke structure of trade. On the other hand, it is important that sufficient external financial assistance be forthcoming, as this would enhance the political feasibility of trade liberalization and other reforms, by offsetting some of the fiscal losses and facilitating the necessary restructuring.

VI. Policy Implications and Conclusions

Over the past decade, MENA's growth in trade has lagged behind that of virtually all other regions of the world, the region has become less integrated into the world economy, and real per capita incomes have declined. The continued pursuit of inward-oriented policies, together with the decline in oil prices, account in large part for this disappointing performance. The non-oil MENA economies remain among the most protectionist countries in the world—a policy stance that has led to a deterioration in productivity and has adversely affected the welfare of their populations. However, promising progress is apparent in a number of countries under Fund-supported programs or under the EU-Mediterranean Initiative. While the major oil economies of MENA have pursued relatively open trade policies, they have had limited success in diversifying their economic base and expanding their exports beyond the petrochemical sector and so have retained their dependence on the international oil market.

The MENA countries are at an important juncture. Given the increasing globalization and integration of the world economy, they must act rapidly to participate in this process by implementing appropriate outward-oriented policies that will lead to an increase in productivity and trade, and thereby an improvement in the standards of living of their populations. Failure to act will leave them lagging even further behind other regions, which have begun to reap the benefits of trade liberalization, and other structural reforms.

Fortunately, the impetus for MENA to act rapidly is now in place—in the form of the multilateral trade liberalization initiatives currently underway. Policy makers in the region have generally recognized the opportunities presented by the Uruguay Round and the EU Mediterranean Initiative and have begun to take the steps necessary to reap the benefits. The policy implications for MENA of these initiatives vary from one country to another, depending on their current trade regime, including any preferential agreements in effect; the commitments made, if any, within the framework of the WTO; the country's resource endowment; and the magnitude of current distortions in the economy that have arisen from the imposition of trade and other restrictions.

There will be costs to trade liberalization for many countries—both from the loss of preferential access to certain markets, increased exposure to international competition from other producers, and the higher prices for food imports. In addition, there are likely to be fiscal losses, as well as social and economic costs arising from the displacement of workers as previously protected sectors are opened to competition, and before other sectors expand to create additional employment opportunities.

However, these costs can be minimized. The transitional costs of trade liberalization can be ameliorated if complementary macroeconomic and regulatory reforms are undertaken and appropriate outward-oriented policies pursued. The conclusion of bilateral arrangements with the EU would also help to broaden the opportunities for trade, by securing market access, anchoring reform and regulatory changes, enhancing credibility in countries' commitment to trade liberalization, and encouraging investment. Furthermore, the financial assistance available from the EU to offset the costs of trade liberalization (including, for example, the loss of trade-related fiscal revenues) and to support the broader reform efforts will be important in easing the resistance of domestic interest groups.

In addition to minimizing the costs, MENA countries should aim to maximize the benefits of the multilateral trade liberalization initiatives. Specifically, full participation in the WTO, including ambitious commitments to roll back protectionist barriers, will only enhance the region's prospects for global integration. Evidence demonstrates that outward-oriented trade strategies are more likely to promote rapid economic growth. However, the ability of MENA countries to reap any potential gains from the worldwide growth-generating effects of trade liberalization will depend importantly on the responsiveness of their economies to new opportunities. This will depend on their ability and willingness to:

- participate fully and actively in the multilateral initiatives, including by making substantive commitments to implement trade liberalization. This would lock in reform and enhance credibility of MENA countries, as well as increase transparency of the domestic economic and regulatory environment;

- pursue appropriate macroeconomic policies that foster sustainable, noninflationary growth, to ensure that the region will attract investment for the development of a more diversified productive structure and maintain the competitiveness of its successful export sectors;

- eliminate regulations and restrictions that inhibit the efficient allocation of resources among sectors, and adopt other supportive structural reforms, to increase the efficiency of the productive sectors;

- achieve a stable security situation within the region, which, together with the above reforms, will help to attract foreign investment and encourage the retention of domestic capital within the region; and

- attain greater intraregional integration, by promoting free trade agreements among MENA countries, developing an investment code that conforms to international standards, and pursuing policy harmonization. Not only would such measures help to avoid the adverse impact of the hub-and-spoke structure of trade that could develop under the EU-Mediterranean initiative, it would also boost merchandise trade, enhance service flows, and encourage intraregional investments.

In sum, the MENA countries have much to gain from the multilateral trade liberalization initiatives. However, in order to reap a proportion of the worldwide welfare enhancing benefits of such liberalization, and to avoid being marginalized, the region will need to act rapidly to adopt more outward-oriented policies and increase the flexibility of their economies. Through these channels, MENA countries will be able to improve resource allocation, attract investment, and achieve higher productivity levels and accelerated economic growth. While it might be difficult for governments to muster the political will to follow this course, success will help governments to achieve their objectives of reducing unemployment, increasing job opportunities for new entrants to the labor market, and improving the living standards of their populations.

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