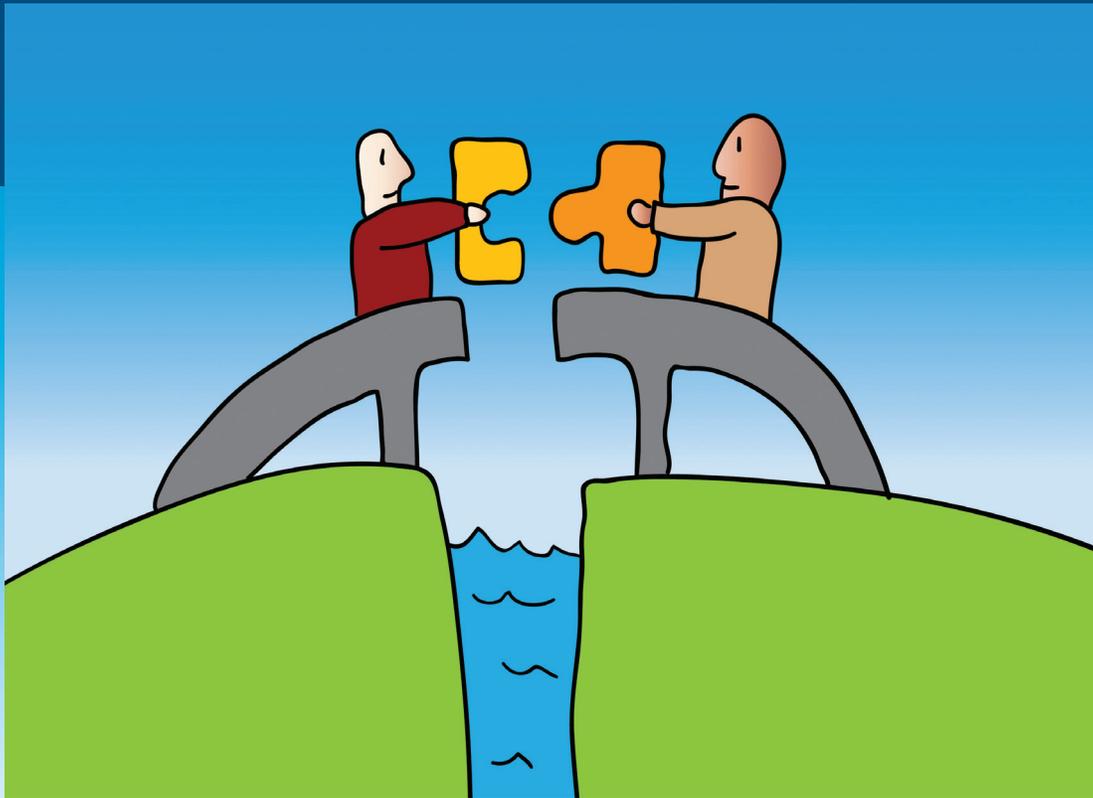


## MENA DEVELOPMENT REPORT

# From Political to Economic Awakening in the Arab World: The Path of Economic Integration

A Deauville Partnership Report on Trade and  
Foreign Direct Investment



THE WORLD BANK



# **From Political to Economic Awakening in the Arab World: The Path of Economic Integration**

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and Foreign Direct Investment**

**Overview Report**



The Marseille Center for  
Mediterranean Integration



THE WORLD BANK



Islamic Development Bank



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## ABBREVIATIONS

ACAA	Agreement on Conformity Assessment and Acceptance
ASEAN	Association of Southeast Asian Nations
CSP	concentrated solar power
DCFTA	Deep and Comprehensive Free Trade Area
ECA	export credit agency
ENP	European Neighbourhood Policy
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GDP	gross domestic product
ICT	information and communications technology
KE	knowledge economy
MENA	Middle East and North Africa
MENA TIP	Middle East/North Africa Trade and Investment Partnership
MFN	most favored nation
MRA	mutual recognition agreement
NAFTA	North American Free Trade Agreement
NTM	nontariff measure
OIC	Organisation of Islamic Cooperation
PAFTA	Pan-Arab Free Trade Area
PTA	preferential trade agreement
R&D	research and development
RIA	regulatory impact assessment
SME	small and medium enterprise
SPS	sanitary and phytosanitary
TIR	International Road Transport (Transports Internationaux Routiers )
WTO	World Trade Organization

## EXECUTIVE SUMMARY

*i. The forces unleashed by the Arab political awakening have the power to be transformational. One critical parameter of success will be whether the Arab political awakening is accompanied by a concurrent economic awakening.* Such an economic awakening would need to generate quality employment for the millions of young men and women who are looking for jobs and a decent life. In most Arab countries, it has become evident that the development paradigm of the past could not achieve the qualitative and inclusive growth expected by the population. The partnership launched initially by the G8 Heads of State in Deauville, France, in May 2011 to support the historic political and economic transformation under way in the region is thus strategic and timely. The “Deauville partners” include Canada, France, Germany, Italy, Japan, Kuwait, Qatar, Russia, Saudi Arabia, Turkey, the United Arab Emirates, the United Kingdom, the United States, and nine associated international and regional financial institutions. All have expressed their commitment to support the “Partnership countries” currently engaged in political and economic transformation: Egypt, Jordan, Libya, Morocco, and Tunisia.

*ii. Economic integration through increased trade and foreign direct investment (FDI) is one key means available in the short to medium term to policy makers to put the Partnership countries on a higher path of sustainable economic growth and in a position to decisively tackle the problem of unemployment, especially youth unemployment.* In Jordan, for instance, more than 70 percent of the unemployed are under 29 years old. Economic integration, both unilateral and in a regional cooperation context, has proven to be a key ingredient of development in many emerging economies. High-performing countries, that is, countries that have grown at an average rate of 7 percent or more a year for 25 years or longer since 1950, used the global economy to increase productivity through trade, FDI, technology flows, and migration. All engaged in and tried to make the most of the global economy, not to push the technological frontier but to catch up with existing technology and knowledge—a much more manageable task. In choosing such a development path, including a reform process of regulatory convergence with the European Union (EU), Turkey has been able to create more than 3 million new jobs since the mid-2000s. Through trade and investment, Deauville partners can therefore help newly democratizing Arab countries embark on inclusive export-led growth and achieve their objectives in two main ways: by effectively expanding market opportunities and by supporting the public policy and regulatory reforms that would be necessary to reap the benefits of greater integration into global markets.

*iii. To be sure, skepticism abounds in the region over the merits of trade and FDI and the integrity of the private sector in light of “crony capitalism,” where the benefits of past policies are perceived to have accrued only to a well-connected few.* There are legitimate concerns over income and wealth inequalities. Many regions are lagging behind. Unemployment rates, especially for youth and women, are skyrocketing. New leaders are understandably preoccupied with pressing domestic political and institutional matters. There is the urgency of economic stabilization in a very difficult global economic environment. The eurozone crisis is hitting oil importers in the Middle East and North Africa

(MENA) region hard. Managing expectations and the political economy of reforms in this period of transition appears more daunting than ever before. The atmosphere in the region is therefore not about the importance of economic integration—even if a new momentum for increased intra-Arab integration is perceptible. Yet, greater integration of MENA’s economies, and of the countries undergoing a transition, will need to be part of any sustainable and inclusive economic recovery. An absolute priority for the Deauville Partnership is to help all stakeholders maintain the long view and do no harm.

*iv. One implication of the emergence of global value chains as well as the experience of Partnership countries with past reforms is that the trade and investment policy agenda increasingly goes beyond the traditional domain of trade ministries to include many domestic behind the border policies and regulations.* A corollary is that this new agenda spans a wide range of public policy areas that are the responsibility of other parts of government, including a variety of regulatory agencies. When an economic opening is not accompanied by domestic reforms to promote competition and transparency in the domestic market, by the reallocation of factors through market flexibility, and by the adjustment of relative prices, the effect is often to displace rents rather than reduce them. Under such circumstances, the gains from economic liberalization can be captured by a well-connected few. In the same vein, the benefits of economic opening cannot be fully reaped if the design and governance of public policies, including sectoral policies, distort economic decisions and stifle competition. A new integration strategy through trade and FDI should therefore show a clear break from the past. Such a strategy will need to confront political and political economy challenges, both from vested interests that benefit from markets not open to greater competition and from groups that have an instinctive resistance to inward FDI and greater imports. It should only support public policies that are designed and governed to foster growth and welfare.

*v. Leadership is needed in both Partnership countries and Deauville partners to provide a credible long-term vision and explain the mutual benefits of economic integration. One such powerful vision could be the pursuit of a partnership aimed at gradually promoting four key freedoms in the Mediterranean and beyond: the free movement of goods, services, capital, and eventually persons.* Trade and migration in the economic space encompassing the European Union, Turkey, the Balkans, the Maghreb, the Mashreq, and the Arabic peninsula has been happening for millennia. Now is the time to recognize these links across the Mediterranean and build bridges aimed at forging a common destiny. The vision of a common Mediterranean economic space, if offered, could provide both the framework and motivation for implementing difficult policy reforms in Partnership countries. In the current uncertain global economic environment, the ability of leaders to offer a transcendent, outward-oriented vision is certainly constrained; yet it will determine the chances for growth and prosperity in the Mediterranean region. The benefits could go beyond the immediate economic returns, serving to promote common human values, peace, and stability.

*vi. Deauville partners share with Partnership countries the responsibility for offering a clear, understandable, and ambitious vision for the Arab people as they pursue their democratic transition.* The vision would be to help integrate the Partnership countries into the world economy, including through the creation of a common economic space spanning the two rims of the Mediterranean and embracing the Gulf Cooperation Council (GCC) countries as well. While each partner or group of partners will naturally continue to pursue detailed trade and investment discussions on a bilateral basis,

the Deauville Partnership could be an instrument of increased synergy and coherence in trade and investment matters among partners.

- The **European Union** could deepen its trade relationships with Egypt, Jordan, Morocco, and Tunisia, developed under the Association Agreements and the European Neighbourhood Policy, with the effective implementation of the proposed Deep and Comprehensive Free Trade Areas (DCFTAs). DCFTAs will be comprehensive agreements on trade and economic relations covering a full range of regulatory areas of mutual interest, such as trade facilitation, technical barriers to trade, sanitary and phytosanitary measures, investment protection, public procurement, and competition policy.
- In a coordinated and coherent approach, and on the basis of its growing political and economic influence in the region, **Turkey** could similarly deepen its existing Association Agreements with each Partnership country to foster trade and investment in the agricultural and services sectors and promote labor mobility. This could build on Turkey's memorandums of understanding with Tunisia (recently signed) and Libya (expected).
- The **Gulf Cooperation Council** could strengthen its relationship with Egypt and Tunisia (Jordan and Morocco have already been officially invited to join the GCC), in the framework of a deepened cooperation with the Agadir agreement. This would allow citizens of member countries to enjoy equal rights and privileges, including the rights to move, settle, and work; receive social protection, retirement, health, education, and social services; and engage in various economic activities and services.
- Consistent and in coordination with initiatives being undertaken by the EU and other Deauville partners, the **United States** could (a) increase the value of its existing agreements with Jordan and Morocco, and (b) invite Tunisia and, once the appropriate circumstances are in place, Egypt and Libya to enter into free trade agreements as well. These actions would be part of the proposed Middle East/North Africa Trade and Investment Partnership (MENA TIP), which will include a broad set of arrangements designed to increase job creation, trade, and investment between and among the United States and countries in the region.
- Deauville partners could also help promote intra-Arab regional integration and integration of Partnership countries into global markets. The Agadir agreement between Egypt, Jordan, Morocco, and Tunisia could be deepened, and Libya could receive the necessary support to join the World Trade Organization (WTO).

vii. ***To signal their determination to pursue a coherent, ambitious, and credible vision in support of the political and economic transition of Partnership countries, the main Deauville partners could join forces to announce commitments in six areas with high immediate jobs potential.*** Those six areas and the various recommendations of the report, including their prioritization and sequencing, were identified following a consultation process with most of the countries and partners concerned.

- **Agriculture.** Improve Partnership countries' access to the agricultural, processed agricultural, and fisheries markets of Deauville partners, particularly for fruits, vegetables, and olive oil. Steps would include the progressive abolition of quotas, reference prices, seasonal restrictions, domestic and export subsidies, and other nontariff barriers to agriculture trade.
- **Manufacturing.** Negotiate mutual recognition agreements, such as Agreements on Conformity Assessment and Acceptance of industrial products (ACAAs), between Partnership countries and Deauville partners to reduce the market fragmentation effect of technical barriers to trade. This is especially relevant in priority sectors that account for a large part of Partnerships countries' exports and employment, such as mechanical and electric industries and construction materials.
- **Services.** Negotiate between Partnership countries and Deauville partners specific sectoral commitments on labor mobility, especially for skilled workers, as part of Mode 4 on the movement of persons in future deep and high-quality trade agreements with Deauville partners.
- **Energy.** Negotiate a multilateral agreement on solar energy imports from the Middle East and North Africa that will govern how the parties share the burden of paying for the incremental cost of solar imports. (European subsidies for renewable energy could be made available for imports, with appropriate adjustments.) The agreement could be concluded initially between Morocco and interested EU member states, such as Germany, Spain, France, Italy, and perhaps others. Other Partnership countries could also be invited to join the agreement, depending how fast they move with concentrated solar power projects.
- **Migration.** Launch labor mobility partnerships or similar mobility schemes between Partnership countries and Deauville partners, including visa facilitation for some categories of workers, readmission, concerted border management, and easier access to the job market of the Deauville partners, especially for less-skilled workers from Partnership countries.
- **Intra-Arab integration.** Adopt and implement simpler and more liberal rules of origin in preferential trade agreements between Partnership countries and Deauville partners, including an improved EU regional convention on preferential Pan-Euro-Mediterranean rules of origin.

viii. ***The implementation of far-reaching domestic reforms in Partnership countries would be critical to effectively reap the growth and employment opportunities offered by greater economic integration and regulatory convergence with the most advanced economies.*** In facing and adapting to a rapidly changing trade and investment landscape, Partnership countries have all recognized and emphasized the importance of taking a new comprehensive approach to trade and investment in their competitiveness and development strategies. Trade and investment were at the core of the countries' action plans submitted at the G8 Finance Ministers' Meeting in Marseille in September 2011 to boost inclusive growth, employment, and productivity. To further enhance trade and FDI and to achieve the vision of an Arab world more integrated into global markets, the trade and commerce pillar of the Deauville Partnership could therefore focus on four overarching priority areas of reforms and support: (a) improve market access opportunities and market regulations; (b) foster competitiveness, diversification, and employment; (c) facilitate trade and mobilize trade finance and diaspora resources;

and (d) promote the inclusiveness, equity, and sustainability of the structural transformation brought about by the process of integration. These are discussed briefly below.

### *Market access opportunities and market regulations*

*ix. The ability of the Partnership countries to use trade and FDI to advance their development objectives depends in part on the market access conditions that confront their exports and on the policies affecting their imports of goods and services.* On both fronts, the Deauville Partnership could help lower trade and investment costs, spur economic growth and employment, and promote the economic integration of Partnership countries—with each other, with regional partners, and with the G8 countries. Rules and discipline are key to market access opportunities that are predictable, transparent, and nondiscriminatory. There are six priorities for the Deauville Partnership in this area:

- Improve market access for agricultural products and encourage investment to upgrade sanitary and phytosanitary standards, promote agricultural research and extension, and deliver efficient irrigation services. As a significant first step, Morocco could expect to export an additional 58,700 tons of tomatoes and 13,600 tons of olive oil per year once the agriculture agreement recently signed with the EU enters into force.
- Reduce tariffs on manufactured goods; streamline unnecessary nontariff measures to reduce trade compliance costs, red tape, and discretion; adopt liberal rules of origin; and upgrade industrial norms and standards, testing, and certification procedures. There is much scope for expanding trade in goods in the region. Excluding petroleum exports, the MENA region, with over 400 million people, exports roughly the same amount as Switzerland.
- Enable services trade to move up the value chain by fostering services liberalization and regulatory reforms, improving regional connectivity and cooperation, and supporting the presence of global services providers. A study conducted in India estimated that a one-standard-deviation increase in the aggregate index of services liberalization resulted in a productivity increase of 11.7 percent for domestic firms and 13.2 percent for foreign enterprises.
- Promote solar energy exports, including through a multilateral agreement, concluded in the near term between interested EU and MENA countries, providing for nondiscriminatory market access for concentrated solar power exported from MENA to those EU countries. Over the medium term, expand transmission infrastructure, synchronize power grids, and open up predictable access to transmission systems. Based on solar exports to Europe, manufacturing of concentrated solar power equipment in the Partnership countries could eventually create more than 80,000 jobs and demonstrate the impact of market access, technology transfer, and diversification.
- Formulate comprehensive labor mobility strategies and open a sensible dialogue on ways to achieve a mutually beneficial increase in labor mobility through new mobility schemes (South-North but also North-South), especially for less-skilled workers, based on an incentive-compatible design under the principle of shared responsibility. Nothing separates an individual

from the benefits of development as much as a work visa. Canada's Seasonal Agricultural Workers Program builds on bilateral agreements to bring about 20,000 workers from Mexico, Central America, and the Caribbean annually to do seasonal work on Canadian farms for up to eight months.

- Promote the process of regulatory convergence of norms and standards and other behind-the-border regulations related to competition policy, government procurement, and other trade- and FDI-enhancing aspects of the regulatory environment. For an average developing country like Morocco where government spends about 15 percent of its national income on goods and services, a 10 percent saving on procurement contracts is equivalent to 1.5 percent of GDP—an amount that often exceed the total amount of aid received.

### *Competitiveness, diversification, and employment*

x. ***An important reason that Partnership countries have not been able to save and invest in the future as much as other successful emerging economies is an overall lack of competitiveness and diversification.*** Competitiveness is central to harnessing private sector growth for sustainable employment, poverty reduction, and, ultimately, wealth creation. Firms, especially small- and medium-size ones, serving export and domestic markets in all sectors cannot exploit opportunities if they are burdened by costs outside their control that make them uncompetitive. Increasing the number and value of products produced, the number of markets served, and the survival rate of firms is conditional on lowering such costs. And Partnership countries need investment now. This requires economy-wide policies and regulations aimed at creating the proper business environment and investment climate, including trade policy (restrictions on imports and FDI); trade in services as a new means to access international best practices and expand exports; and the design and implementation of specific actions to address market and information failures. There are four priorities for the Deauville Partnership in this area, including absolute priority for the recommendations aimed at attracting FDI and fostering domestic investment:

- Strengthen the FDI regime by phasing out de jure and de facto restrictions on foreign equity participation in most economic sectors; simplifying and rationalizing investment regimes; easing access to production factors (industrial land, foreign exchange, and expatriate workers); completing privatization programs; and launching negotiations with Deauville partners on investment. For example, privatization and other reforms in the telecommunications sector in Jordan in the mid-2000s generated 25,000 additional jobs.
- Improve the domestic business climate by fostering competition and limiting opportunities for rent seeking; building strong rule-bound market institutions to reduce discretion and opacity; and promoting new institutional dialogue among stakeholders on the design, implementation, and evaluation of policies. Barriers to the process of “creative destruction” in Partnership countries are enormous. The average age of firms in the MENA region is almost 10 years older than the average for firms in East Asia or Eastern Europe. Croatia's working-age population is comparable in size to Jordan's, but the average number of newly registered firms in Croatia was almost five times higher in 2004–2009.

- Address structural economic governance issues by fighting corruption, discretion, and the uneven implementation of policies; restoring voice, accountability, and checks and balances; strengthening the rule of law and the level playing field; and promoting transparency through freedom of information. Jordan is the first MENA country that is a member of the Open Government Partnership, which includes 53 countries from around the world. The other Deauville Partnership countries should seek to meet the eligibility criteria of fiscal transparency, access to information, assets disclosure and citizen engagement as soon as possible.
- Foster the four pillars of a knowledge economy aimed in the first instance at catch-up growth (i.e., imitation) by harnessing more technological spillovers from existing and future FDI; launching a major overhaul of education systems, including effective vocational training programs; developing comprehensive knowledge and innovation strategies; and further diffusing information and communication technologies. Romania, which competes with Morocco in offshoring, has nine times the international bandwidth capacity per capita.

### *Trade facilitation, trade finance, and remittances*

*xi. Tackling costs associated with inefficient trade facilitation and logistics and weak access to trade finance and remittances is central to further integration of Partnership countries, both regionally and globally.* The costs of “connectivity” are often fixed, and as a result they disproportionately affect small firms, farmers, and the poor, severely limiting their participation in trade and investment. Reducing the costs associated with moving goods along international supply chains, whether these costs are measured in terms of time, money, or reliability, is a core element of a trade and FDI agenda. Such costs are also partly determined by access to and pricing of trade finance and associated export credit insurance products. This factor has become more important for Partnership countries’ exporters, especially small and medium enterprises (SMEs), since the recent crisis, as higher financing costs are expected to prevail in the medium term. There are three Deauville Partnership priorities in this area:

- Modernize trade facilitation services by enhancing the performance of trade corridors, whether air, sea, or land, and network infrastructure for energy and telecommunications; improving markets for logistics services; increasing the efficiency of border management, including customs; and facilitating the cross-border movement of service suppliers. Container dwell times in Morocco or Tunisia are about a week, compared to 4 days in Malaysia and 2.5 days in Shanghai. Trade logistics costs can be as high as 26 percent of the product price for Jordanian potatoes and 15 percent for Egyptian garments.
- Improve access to affordable trade finance and related insurance and guarantee products for SMEs, including Islamic finance; build the technical capacity of both SMEs and financial institutions in the management of trade finance at all transaction stages; and develop new inter-firm finance products, such as factoring. Only 20 percent of SMEs in MENA have a loan or line of credit, a significantly lower share than in all other regions except Sub-Saharan Africa.

- Harness the remittances, technology and skills transfer, and investment of workers abroad by strengthening engagement with the *diasporas*, using government institutions such as embassies and consulates; mobilizing diaspora savings through the issuance of targeted financial instruments, such as diaspora bonds; and establishing more dedicated diaspora programs to promote development in the origin countries. The intra-regional movement of people dwarfs the movement of goods in the Arab world. Diaspora remittances sent to Jordan and Egypt from other Arab countries are 40 to 190 percent higher than trade revenues between these and other Arab countries.

### *Inclusiveness, equity, and sustainability*

*xii. The process of integration—like the process of change brought about by technological progress—benefits society at large, but it also generates winners and losers.* To be sustainable, the political economy of trade and FDI requires that the benefits of integration, which are often concentrated in the large cities and among the more privileged sectors of the population, be shared as widely as possible across regions and people. Addressing and dealing effectively with the short-run distribution effects of opening up and technological upgrading will probably be the most critical social challenge facing the Partnership countries in the coming years. Trade and FDI are more than simple exchanges of material goods and services: they have to do with people and their expectations, norms, and values. Trade partners need to recognize the possible tensions between those norms, as they relate for instance to women’s rights, labor rights, or other human rights, and find ways to ease these tensions over time. There are three priorities for the Deauville Partnership in this area:

- Target social policies to help the most vulnerable people manage trade- and FDI-related shocks, address the needs of the unemployed during transition periods, and retrain workers in sectors that lose as a result of integration. In Partnership countries, the rich tend to receive a larger share of consumption subsidies in absolute terms than the poor especially gas and water subsidies. In Jordan, the poor receive only 11.1 percent of total subsidies.
- Develop regional policies to connect lagging and remote regions to urban centers, promote internal trade, and help poor people in these areas connect to the places where opportunities are concentrated. In Morocco and Tunisia, only about 40 percent of the population lives within two kilometers of an all-weather road.
- Promote common societal policies in trade and investment rules, including in the areas of women’s rights, labor rights, and other human rights. Female labor force participation rates in Egypt, Jordan, and Morocco are about half that of Indonesia.

*xiii. In each of these four priority areas—market access, competitiveness, trade facilitation, and inclusiveness—the attached report recommends a number of selected steps that Partnership countries could consider implementing in the short and medium term with the support of their Deauville partners.* While the report focuses on the challenges that are largely common to all five Partnership countries, it does not propose a single blueprint. Heterogeneity across countries and industries implies that there is no one-size-fits-all approach and that all partners need to be willing to learn and adapt to the

local social and political processes most conducive to the desired long-term objectives. While the recommended policy actions are prioritized and sequenced in each of the four priority areas, the areas themselves are essentially complementary in their effects and so offer few opportunities for trade-offs. Governments need to tackle the formidable list of policies that would need to accompany greater openness—often with limited administrative capacities. The onus is on the G8 and other Deauville partners—notably the international and financial institutions involved—to provide the necessary technical assistance, capacity building, and financial resources to support the Partnership countries individually and as a group in their own reform efforts.

*xiv. The comprehensiveness of the proposed integration strategy is also designed to facilitate its political feasibility and acceptance.* Although any single efficiency-enhancing reform may hurt a particular group or individual, once part of a broad and comprehensive reform agenda, the potential negative effects of reform tend to cancel out each other, making everyone a winner. A focus of the Deauville partnership should therefore be to support the establishment of credible domestic public-private consultative mechanisms to identify the difficulties faced by exporters, investors, and other economic actors in the expansion of their activities and propose broad and comprehensive solutions to these difficulties. The building of strong and influential pro-reform constituencies that can advocate change, including by promoting jobs and inclusion, will be a critical determinant of the Arab economic awakening. The Deauville Partnership itself could become a supranational mechanism to coordinate integration initiatives, help deal with possible negative externalities, and promote regional public goods and the commons. This may also be a way to unify the three pillars of the partnership: the trade and commerce pillar would converge with the governance and finance pillars to support the democratic transition and homegrown strategies for sustainable growth and employment.



# FROM POLITICAL TO ECONOMIC AWAKENING IN THE ARAB WORLD: THE PATH OF ECONOMIC INTEGRATION

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## 1. INTRODUCTION

1. ***The forces unleashed by the Arab political awakening have the power to be transformational.*** In a number of countries, formerly disfranchised citizens have started to reclaim their basic rights and dignity and have voiced their demand for a new social contract, underpinned by the principles of freedom and open governance and by a more inclusive socioeconomic development strategy. Whether the Arab Spring will give birth to vibrant, long-lasting democracies that promote peace, security, and all fundamental freedoms remains to be seen. The result will not be known for years, perhaps even decades. The revolutions in Tunisia and Egypt exposed the structural deficiencies in the countries' governance structures and highlighted the weaknesses of the previous development model, which was unable to provide economic opportunities to all citizens, in particular jobs for educated youth.

2. ***One critical parameter of success will be whether the Arab political awakening is accompanied by a concurrent economic awakening.*** Economic conditions in the fragile nascent democracies, perhaps more than any other factor, will determine the fate of the Arab Spring. Freeing the entrepreneurial spirit, moving from privileges to merit, and establishing fair and transparent rules of the game are preconditions for unlocking private sector-led growth and employment. In the aftermath of the Arab spring, countries in the Middle East and North Africa (MENA) region have a historical window of opportunity in which to transform their governance structures and development strategies by implementing comprehensive institutional reforms, both economic and political.

3. ***In most Arab countries, it has become evident that the development paradigm of the past cannot achieve the qualitative and inclusive growth expected by the population.*** A singular failure of the Arab world is that it has been unsuccessful in developing a strong private sector that is connected with global markets, survives without state crutches, and generates productive employment for its young (Malik and Awadallah 2011). Although the state-business relationship varies tremendously across the region, it is usually a personalized rather than an institutionalized relationship. Businessmen are often connected with rulers through overlapping networks, which usually makes their engagement with the state informal, exclusive, and short-term (Luciani and Hertog 2010). Public expenditure—increasingly constrained—and a bloated civil service can no longer compensate for the failure of these policies to create economic opportunities and jobs. The Arab countries that have traditionally preserved their social order through a combination of repression and redistribution need a fundamental rethinking of their social contract. It is now widely recognized that sustainable economic growth and job creation can only be achieved by fully unlocking private initiatives, innovation, and investments, both domestic and foreign, maximizing the benefits of an increasingly integrated world. The newly democratic Arab nations therefore need economic opportunities, far-reaching reforms, and multipronged support. Above all, they need a vision that Arab peoples can trust to channel their energy toward high-quality, sustainable, and inclusive growth.

## *The Deauville Partnership*

4. ***The partnership launched by the G8 in Deauville, France, in May 2011 is thus strategic and timely.*** It provides a platform to support the historic political and economic transformation under way in some countries in the MENA region. Recognizing that the private sector must be the engine of growth and job creation, the Deauville Partnership aims to promote trade and investment, enhance support to private sector development, and coordinate support from international and regional financial institutions for homegrown economic and governance reforms. The Deauville “partners” include Canada, France, Germany, Italy, Japan, Kuwait, Qatar, Russia, Saudi Arabia, Turkey, the United Arab Emirates, the United Kingdom, the United States, and nine associated international and regional financial institutions.<sup>1</sup> All have expressed their commitment to support the “Partnership countries” currently engaged in political and economic transformation: Egypt, Jordan, Libya, Morocco, and Tunisia. Building on the country programs, the partners will help the Partnership countries achieve macroeconomic stability, social cohesion, and more equitable growth. Given the increasing fragility of the macroeconomic fundamentals in the region and the Partnership’s focus on regional integration, it was decided to organize the Deauville Partnership around three pillars: governance, finance, and trade and commerce.

5. ***At the Deauville Partnership Finance Ministers’ Meeting in Marseille, France, in September 2011, ministers launched the finance pillar of this Partnership in support of the Partnership countries engaged in political and economic transformation: Egypt, Jordan, Morocco, and Tunisia.*** In Marseille, the finance ministers affirmed that regional and global integration is key to the economic development of the Partnership countries. Noting that increased integration would require action both within the region and with external partners, they expressed their commitment to advance and complement their respective bilateral and multilateral initiatives, including by removing barriers to trade and investment. They supported the acceleration of ongoing trade negotiations and efforts for better regional and global integration of the Partnership countries, notably through gradual integration in areas of mutual interest with the G8 countries and progress in the work toward an Arab Customs Union.<sup>2</sup> At a subsequent Deauville Partnership meeting in New York in September 2011, the foreign affairs ministers emphasized the importance of regional integration for the Partnership and expressed their willingness to enhance existing initiatives by providing broader mutual market access opportunities and reducing barriers to trade and investment.<sup>3</sup>

6. ***In order to provide an appropriate framework in which to enhance trade and foreign direct investment, the Deauville Partnership requested the Marseille Center for Mediterranean Integration, drawing on the expertise of the World Bank and in partnership with the Islamic Development Bank, to coordinate an analytical report to be completed by early 2012.***<sup>4</sup> This overview report and the main report it accompanies are the response to the Deauville Partnership request. The thrust of the report is that economic integration through increased trade and foreign direct investment (FDI) is one key means to put the Partnership countries on a higher path of sustainable economic growth and in a position to

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<sup>1</sup> The African Development Bank, Arab Fund for Economic and Social Development, Arab Monetary Fund, European Bank for Reconstruction and Development, European Investment Bank, Islamic Development Bank Group, International Monetary Fund, OPEC Fund for International Development, and World Bank Group.

<sup>2</sup> Deauville Partnership Finance Ministers’ Meeting Communiqué, Marseille, September 10, 2011, para. 13.

<sup>3</sup> Deauville Partnership Foreign Affairs Ministers’ Meeting Communiqué, New York, September 20, 2011, para. 23.

<sup>4</sup> Deauville Partnership Finance Ministers’ Meeting Communiqué, Marseille, September 10, 2011, para. 14.

decisively tackle the problem of unemployment, especially youth unemployment. And trade and investment are a means available to policy makers of the Deauville Partnership to show results in the not-too-distant future. G8 countries, Turkey, the Gulf states, and other Deauville partners can help the new Arab democracies achieve their objectives in two main ways: by effectively expanding market opportunities and by supporting domestic policy and regulatory reforms.

### *Why trade and FDI?*

7. ***To be sure, the quest for long-term, inclusive, and sustainable growth remains as elusive as ever.*** The prescription—if there is any prescription—for achieving and sustaining high rates of economic growth and job creation seems to require a myriad of ingredients in uncertain dosages adapted to local economic and political realities. Above all, determining and prioritizing the key drivers of growth and employment is an enormous challenge that confronts all developing and developed countries alike, including those united in the Deauville Partnership. In all sectors—health, education, energy, and so on—institutions, policies, and practices need improvement, but it is often unclear which ones deserve priority attention. Policy makers may be tempted to retreat from a long-term strategic vision to address more immediate, but less consequential, issues of the day. Well-intended policies with a short-term focus often have adverse unintended consequences in the long run. The Deauville Partnership therefore should be seen as an opportunity to develop a shared vision for the long-term prosperity and stability of the Mediterranean region.

8. ***Even so, the successful emerging economies over the last 60 years have had striking points of resemblance.*** The Commission on Growth and Development (2008) found that the economic success of these countries involved five key ingredients. They had committed, credible, and capable governments; they maintained macroeconomic stability; they fully engaged in and made the most of the world economy; they let markets allocate resources; and they mustered high rates of saving and investment.<sup>5</sup> The high-growth economies typically built their prosperity on sturdy political foundations. In fast-growing economies, policy makers understood that successful development entails a decades-long commitment and a fundamental bargain between the present and the future. Even at very high growth rates of 7–10 percent, it takes decades for a country to make the leap from low to relatively high incomes. During this long transition period, citizens must forgo consumption today in return for higher standards of living tomorrow. This bargain will be accepted only if the country’s policy makers convey a credible vision of the future and a strategy for getting there. They must be trusted as stewards of the economy, and their promises of future rewards must be believed. Then, and only then, can policies aimed at maintaining macroeconomic stability, opening up to regional and international trade and investment, and fostering market forces produce their full benefits. This is the central premise of this report.

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<sup>5</sup> Throughout the report, the performance of the Deauville Partnership countries (Egypt, Jordan, Libya, Morocco, and Tunisia) will be compared with their main competitors as well as with the 13 economies identified by the Commission on Growth and Development (2008) as having grown at an average rate of 7 percent or more per year for 25 years or longer since 1950: Botswana; Brazil; China; Hong Kong SAR, China; Indonesia; Japan; the Republic of Korea; Malaysia; Malta; Oman; Singapore; Taiwan, China; and Thailand.

## *Trade and FDI as vehicles for inclusive growth*

9. ***Economic integration has proven to be a key ingredient of development.*** High-performing countries, that is, countries that have grown at an average rate of 7 percent or more per year for 25 years or longer since 1950, used the global economy to increase productivity through trade, FDI, technology flows, and migration. All engaged in and tried to make the most of the global economy, not to push the technological frontier but to catch up with existing technology and knowledge—a much more manageable task. These high-growth countries benefited from integration in two ways. First, they imported ideas, technology, and know-how from the rest of the world. Second, they exploited global demand, which provided a deep, elastic market for their goods. The inflow of knowledge dramatically increased the economy’s productive potential; the global market provided the demand necessary to fulfill it. As simply put by the Commission on Growth and Development (2008), “They imported what the rest of the world knew, and exported what it wanted.”

10. ***For these successful emerging economies, economic integration through trade and FDI was not an end in itself but a means to promote long-term economic growth and employment.*** Trade and investment could be seen as two main engines to help promote sustainable economic growth and job creation (Dasgupta et al. 2002)—one of the top concerns of the Partnership countries but also of all countries in the Mediterranean region (Box 1). At a broader level, freedom of exchange is not merely a means to spur economic growth, create jobs, and reduce poverty; it is also a way to advance human liberties, bring people together in peaceful and mutually beneficial exchanges, and promote peace and stability (Chauffour 2009). The massive popular uprisings in Tunisia, Egypt, Libya, Syria, and other parts of the Arab world are the most recent reminder of this universal quest for freedom.

### **Box 1. How does the trade and FDI engine work?**

Trade and investment raise productivity through more efficient allocation of resources, economies of scale, increased competition, faster rates of capital accumulation and technical progress, and increased flows of ideas, knowledge, and innovation from abroad. Trade and investment not only promote faster economic growth and job creation but also help countries move up the global value chain, diversify, and improve their resilience to external shocks. Conversely, government action to restrict access to trade and investment reduces commercial opportunities, increases cost of inputs, and limits job opportunities. It can also limit consumers’ choices, thereby reducing their well-being, and give rise to a variety of rents and rent-seeking behaviors. These threats typically are not limited to the freedom to trade in goods and services but also encompass restrictions on the free flow of capital, technological knowledge, and ideas more generally.

## *Trade and FDI as a means to create jobs*

11. ***The five Partnership countries of the Deauville Partnership display some significant commonalities in their past economic performance.*** The roots of weak private sector performance in the MENA region run deep in history (Kuran 2004). Traders and investors were politically weak under the Ottomans, and Arab socialism of the twentieth century has contributed to this development. However, starting in the early 1990s, growth accelerated in all Partnership countries, driven by an opening up of their economies. There was a surge in trade and foreign direct investment, but little

economic diversification. This led to a reduction of poverty, but not of inequality. Importantly, this improved economic performance made only a small dent in the high unemployment rate, especially among youth, educated people, and women. Meanwhile, the quality of institutions was deteriorating. The many regional integration attempts were largely unsuccessful. Neither the pan-Arab integration agreements nor those linking the Partnership countries with the United States, the EU, or Turkey have succeeded in generating exports and creating jobs. The perception is that these agreements have, more often than not, been associated with dislocations and that the benefits have been captured by a few belonging to the first circle of politically connected. Any new vision would need to show a clear break from this past.

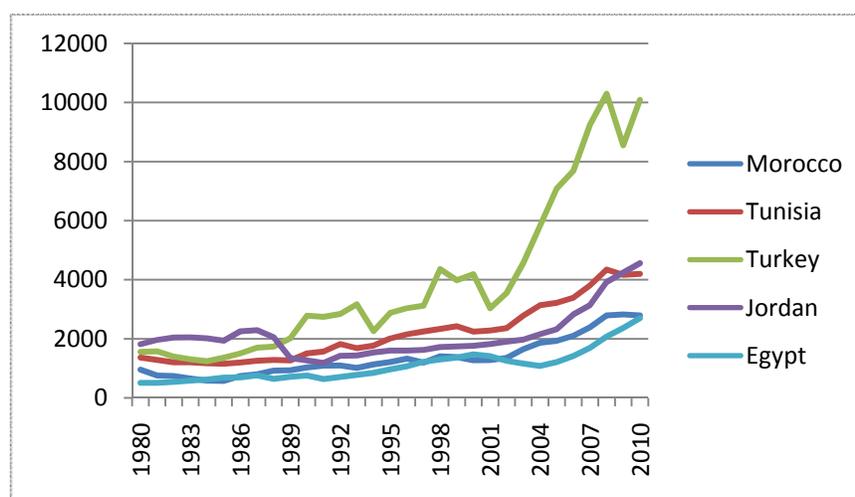
12. ***The Arab awakening has created opportunities for more open societies and inclusive growth. However, in several countries, while the medium-term economic and social outlook is promising, near-term growth prospects are weaker than a year ago.*** This is especially true for the non-oil-exporters—Egypt, Jordan, Tunisia, and Morocco. There have been short-term consequences for economic performance in tourism, trade, and investment, and in some countries remittances have also slowed. Tourism, which contributes 4 and 6 percent of GDP in Egypt and Tunisia respectively, contracted significantly following the revolutions. The region has witnessed significant declines in foreign direct investment. Against this backdrop of economic vulnerability in several MENA countries, the eurozone crisis is now hitting the region hard. As a result, financing needs have increased sharply and are now urgent. The international community must ensure that the promise of the Arab awakening is not compromised by lack of financing at this critical time.

13. ***Given that employment and job creation is the most urgent economic concern in Partnership countries, an integration agenda necessarily constitutes an important element of a strategic policy response.*** Under the right circumstances, integration through trade and investment can promote lasting, high-value-added employment. Reducing barriers to FDI in services in particular has been found to increase demand for more highly skilled labor. Integration can also promote labor market participation, especially among women. In comparison to education and other long-term growth-enhancing policies—which of course are beneficial in their own right—trade and investment can have more rapid effects on growth and employment creation (OECD 2011). Yet such effects of integration (and globalization more broadly) on jobs, wages, and job security are not necessarily immediate. There is evidence that the short-run impact of trade liberalization can be a temporary increase in the unemployment rate due to a job creation time lag and the displacement of workers from previously sheltered import-competing industries. Moreover, the reforms that help expand trade should be part of more comprehensive programs aimed at improving competitiveness and economic efficiency, and these may also entail adjustment costs. On balance, however, in the medium term, expansion of trade and FDI holds promise for substantial dividends in terms of job creation, job quality, and income growth.

14. ***In a number of countries that successfully integrated into global markets, export-led growth eventually brought large employment dividends.*** In many cases—most notably Eastern Europe, Turkey, China, India, and other Asian countries—globalization’s promise in terms of employment has been fulfilled. For example, Turkey has been able to accelerate economic growth and create more than 3 million new jobs since it opened up and entered into a process of regulatory convergence with the EU in the mid-2000s (Figure 1). High-productivity employment opportunities have expanded, and structural

change has contributed to overall growth. Turkey's recent economic performance offers a natural experiment in economic integration that could be particularly relevant for the new Arab democracies (Togan 2012). The expansion beyond national markets of production in developing countries, especially in labor-intensive manufacturing such as textiles and clothing, footwear, and food processing, eventually spurs demand for labor and boosts workers' earnings. Because of weak economic governance and lack of complementary structural transformation, countries in MENA (and also until recently in Latin America and Sub-Saharan Africa) have found it difficult to make trade a driver of employment creation and growth (World Bank 2003). Evidence suggests that trade openness has contributed less to overall employment creation in manufacturing in MENA than in other developing regions. In a number of instances, because of an inadequate economic environment, globalization appears not to have fostered the desirable kind of structural change; instead, labor has moved from more productive to less productive activities, including, most notably, the informal economy.

**Figure 1. GDP per capita (Current US\$)**



Source: World Bank, World Development Indicators, <http://data.worldbank.org>.

15. *Until now, except for the oil sector, MENA has remained one of the least integrated regions, both in terms of intra-regional integration and integration into the world economy.* It has suffered from relatively high trade and investment barriers, poor trade facilitation and logistics, lack of services trade integration, and weak rules and discipline for trade and investment, including for intra-regional trade agreements such as the Pan-Arab Free Trade Area (PAFTA). This creates an opportunity, in that steps to address these deficiencies could yield large beneficial results in a relatively short period of time. Looking forward, economic integration through greater trade and investment is an overarching development strategy that can do for the MENA region what it did before for Central and Eastern Europe, East Asia, and other emerging trading partners that are now sustainable growth poles (Dadush and Shaw 2011). Greater economic integration would be particularly effective in addressing Partnership countries' underperformance in intra-industry trade and investment.

## *Leadership for a trade and FDI vision*

16. ***Leadership is needed in both Partnership countries and Deauville partners to provide a credible long-term vision and explain the mutual benefits of economic integration.*** One powerful vision could be the pursuit of a partnership aimed at gradually promoting four key freedoms in the Mediterranean: the free movement of goods, services, capital, and persons. Trade and migration in the economic space encompassing the European Union (EU), Turkey, the Balkans, the Maghreb, and the Mashreq has been happening for millennia (Braudel 1949; Abulafia 2011). Now is the time to recognize these links across the Mediterranean and build bridges aimed at forging a common destiny (Niblett and Spencer 2012). The vision of a common Mediterranean economic space, if offered, could provide a motivation for difficult policy reforms in Partnership countries. In this bleak global economic environment, the ability of leaders to offer a transcendent, outward-oriented vision will determine the chances for growth and prosperity. The benefits would go beyond the immediate economic benefits, serving to promote common human values, peace, and stability.

17. ***The historical circumstances may also be ripe for Partnership countries to take the lead and make a strong push toward greater regional intra-Arab integration.*** As an overarching purpose, the Deauville Partnership could help current and future Partnership countries and the Arab world more generally invent their own model of integration. To date, intra-Arab integration has been largely a failure. Although Arab countries embarked on economic cooperation earlier than many other developing regions (the Arab Economic Unity Agreement dates back to 1957), and they have signed the highest number of regional integration agreements (more than 20), almost none of these agreements has been implemented effectively. Even some land borders between Arab countries remain closed. Yet regional integration has been a significant driver of better overall performance for countries in Central Europe and Eastern Europe, Southeast Asia, and other regions of the world. The Arab political awakening for greater voice and representation, economic opportunities, and openness more generally could create the circumstances for a genuine new beginning. The Arab world's approach to regional integration should be anchored in the region's evolving realities and circumstances. There are several significant considerations to take into account in advancing regional integration.

18. ***First, such a vision could help the Arab world take better advantage of a shared heritage and common identity.*** There are in fact several Mediterranean and Arab "worlds," or subregions, each with its own characteristics and prospects. The Maghreb countries are economically oriented toward the EU, while the Mashreq countries have a more diverse reach. The third group, the countries of the Gulf Cooperation Council (GCC), are more globally integrated, although overwhelmingly through oil and gas. The larger Arab world is also somewhat more integrated in terms of investment (from the GCC) and labor (into the GCC, but into other subregions too) than in terms of trade. With respect to subregional integration, the three subregions are at different stages of economic convergence. While the GCC countries are moving from a customs union to developing a common market, with a possible monetary union on the horizon, the other two subregions remain internally divided, with longstanding political disputes and/or conflicts. In each subregion, countries are also at various stages of progress toward establishing liberal democracies and open market economies. Yet Arab peoples have more in

common in terms of culture, identity, and sense of belonging than do the populations of many other regional trading blocs.

19. ***Second, the Arab world needs stronger regional engines to power regional cooperation.*** The development of regional cooperative institutions that are efficient and effective appears to be fundamentally driven by the initiative and interests of major regional powers. Integration can take different institutional forms (Balassa 1961). France and Germany were critical in the early stages of the EU; Japan nurtured the “flying geese” model of development in East Asia and took lead in fostering regional cooperation; the United States drove the North American Free Trade Agreement (NAFTA); Russian and Chinese interests may drive the regional integration of Central Asia. However, as in many other regions of the world, it is not yet clear which power or powers in the Arab world could lead and drive regional cooperation. There is no one natural hub or anchor country, as there is in North America. Nor is there a clearly defined subset of equally large countries that have an interest in cooperation, as was the case with EU regionalism (Hoekman and Messerlin 2002). Yet most Arab countries understand that they are now part of a regional architecture and that they have an interest in promoting healthy, dynamic, flexible regional systems and institutions for finance, trade, the movement of ideas and people, and environmental protection, among other functions.

20. ***A third factor is that the emergence of a new, fast-evolving multipolar world economy could help trigger the exceptional conditions that are often required for regional integration.*** The examples of East Asia and Eastern and Central Europe illustrate the kinds of historical conditions that can unleash the integration process, in this case the collapse of Japan after World War II and the discrediting of a political system in Eastern Europe. In the absence of such historical conditions, regional integration tends to be an extremely protracted political process. The current political transformation in the region, coinciding in time with the rebalancing of the world economy, offers unique opportunities for the Arab world. The political transformation could help ease the political tensions between Arab countries and pave the way for a virtuous circle of political cooperation and economic integration. The evolution of Arab countries toward more democratic regimes could foster regional integration, which in turn would reduce political tensions. The move toward multiple poles of growth is accelerating as middle classes grow in developing countries, billions of people join the world economy, and new patterns of integration combine regional intensification with global openness. For the Arab world, the rise of China, India, and the Association of Southeast Asian Nations (ASEAN) offers great opportunities that go beyond the expansion of energy markets (Pigato 2009). Arab countries are an important source of capital for the rest of the world, and increasingly a business-service hub linking East and South Asia with Europe and Africa. The Maghreb could soon be part of a Euro-Med integration system linked to both the Mideast and Africa. The prospects of a Union for the Mediterranean encompassing 43 countries from Europe and the Mediterranean basin could become more favorable with the democratic transitions in North Africa, the Middle East, and the Balkans.

### ***A trade and FDI agenda***

21. ***To start implementing the vision of an integrated economic space in the Mediterranean basin, the Deauville Partnership could focus on five priority areas.*** These are to help Partnership countries (a) adapt to a fast-changing trade, FDI, and jobs landscape; (b) improve market access opportunities and

market regulations; (c) foster competitiveness, diversification, and employment; (d) facilitate trade and mobilize trade finance and diaspora resources; and (e) promote the inclusiveness, equity, and sustainability of the structural transformation brought about by the process of integration. These five areas have emerged as the key priorities from the consultation process with the Partnership countries and the various Deauville partners under the guidance of an Advisory Committee established for the purpose of this report. They are outlined briefly below and discussed in sections 2 through 6 of this overview report.

- ***Adapt to a fast-changing trade, FDI, and jobs landscape.*** The global trade and FDI environment has changed beyond recognition over the last two decades; one does not trade and invest in the same way today as 20 or even 10 years ago. The emergence of production networks, global value chains, and trade in tasks (as opposed to goods or services) is shaping this new environment, changing the skills and competencies required for employment. The Deauville Partnership could foster the development of production networks in Partnership countries and eventually the emergence of an Arab factory system (equivalent to Factory Asia) as a means to accelerate growth, create jobs, including for women, and reduce poverty.
- ***Improve market access and regulations.*** The Deauville Partnership could offer more opportunities to trade and invest across borders cheaply, securely, and predictably. This could be done by increasing market access, especially in areas where Partnership countries have comparative advantages, such as in concentrated solar power; allowing freer labor mobility; and increasing support to the process of regulatory convergence of norms, standards, and other behind-the-border regulations, such as those dealing with competition policy and government procurement.
- ***Foster competitiveness, diversification, and employment.*** The Deauville Partnership could support Partnership countries in the implementation of complementary domestic reforms of their business environment, investment climate, and governance structure. The objective is to develop more knowledge- and innovation-oriented economies that are capable of breaking into new markets, reaping the benefits of globalization, and creating high-value jobs.
- ***Facilitate trade and mobilize trade finance and diaspora resources.*** To support trade and FDI, especially for the development of small and medium-size enterprises, the Deauville Partnership could play a critical role in modernizing trade logistics, customs, and other border agencies, and in mobilizing trade finance and diaspora resources.
- ***Promote inclusiveness, equity, and sustainability.*** The Deauville Partnership could help make the gains from economic integration more inclusive across populations, equitable across regions, and sustainable over time. These are all critical political economy dimensions that can promote ownership and sustain the reform momentum.

22. ***All neighboring partner countries—the EU members, Turkey, and the GCC countries—as well as the United States share with the Partnership countries the responsibility for offering a clear, understandable, and ambitious vision for the Arab people as they pursue their democratic transition.***

The vision would be to help integrate the Partnership countries into the world economy, including through the creation of a common economic space spanning the two rims of the Mediterranean and, in the long run, embracing the GCC as well. This could include steps such as the following:

- The *EU* could deepen its trade relationships with Egypt, Jordan, Morocco, and Tunisia developed under the Association Agreements and the European Neighbourhood Policy with the effective implementation of the proposed Deep and Comprehensive Free Trade Areas (DCFTAs). DCFTAs will be comprehensive agreements on trade and economic relations covering a full range of regulatory areas of mutual interest, such as trade facilitation, technical barriers to trade, sanitary and phytosanitary measures, investment protection, public procurement, and competition policy.
- In a coordinated approach, and on the basis of its growing political and economic influence in the region, *Turkey* could similarly deepen its existing arrangements with each Partnership country to foster trade and investment in the agricultural and services sectors and promote labor mobility. This could build on Turkey’s memorandums of understanding with Tunisia (recently signed) and Libya (expected).
- The *GCC* could strengthen its relationship with Egypt and Tunisia (Jordan and Morocco have already been officially invited to join the GCC), in the framework of a deepened cooperation with the Agadir agreement. This would allow citizens of member countries to enjoy equal rights and privileges, including the rights to move, settle, and work; receive social protection, retirement, health, education, and social services; and engage in various economic activities and services.
- Consistent and in coordination with initiatives being undertaken by the EU and other Deauville partners, the *United States* could (a) increase the value of its existing agreements with Jordan and Morocco, and (b) invite Tunisia and, once the appropriate circumstances are in place, Egypt and Libya to enter into free trade agreements as well. These actions would be part of the proposed Middle East/North Africa Trade and Investment Partnership (MENA TIP), which will include a broad set of arrangements designed to increase job creation, trade, and investment between and among the United States and countries in the region.
- *Deauville partners* could also help promote intra-Arab regional integration and integration of Partnership countries into global markets. The Agadir agreement between Egypt, Jordan, Morocco, and Tunisia could be deepened, and Libya could receive the necessary support to join the World Trade Organization (WTO).
- Last but not least, the implementation of far-reaching domestic reforms in *Partnership countries* would be critical to effectively reap the growth and employment opportunities offered by greater economic integration and regulatory convergence with the most advanced economies.

23. *People in Partnership countries need to see “what is in it for them” in a trade and FDI reform agenda.* Many people in the region perceive that the opening that was implemented by

governments in the last decade did not generate the benefits advertised. Previous attempts to strengthen private businesses through privatization and deregulation often failed when the reforms were implemented halfheartedly and the benefits were largely captured by a well-connected few. External liberalization was not accompanied by domestic reforms to improve governance, increase transparency, and create a level playing field so the benefits of liberalization could trickle down to workers and consumers. Rather than creating a legitimate private sector constituency, then, past reforms tended simply to strengthen existing patronage networks and businesses that were “embedded with those in power” (Malik and Awadallah 2011). To avoid repeating the mistakes of the past, the political economy of the Deauville Partnership will be critical. People in the Partnership countries need to own the process of integration and its overall direction. They need to be aware of the changing global trade and FDI environment and see improved infrastructure for trade and investment. They need to perceive greater economic opportunities for themselves and their children and feel that reform efforts are bearing fruit. Finally, they need convincing evidence that all social groups are benefiting from the process and will continue to do so over time.

## **2. ADAPTING TO A CHANGING TRADE, FDI, AND JOBS LANDSCAPE**

24. *The global trade and FDI landscape is changing rapidly; one does not trade or invest today in the same way as 20 or even 10 years ago.* The emergence of production networks, global value chains, and trade in tasks (as opposed to goods or services) is shaping this new environment. The “trade-investment-service nexus” is at the heart of today’s international commerce (Baldwin 2011). Driven by large reductions in border barriers and technological changes that have lowered, inter alia, the costs of communications and transport, trade and FDI have experienced a global boom in recent decades. The rise in trade in nonmaterial goods, particularly business services, has become a dynamic component of trade as well as a source of export diversification for many developing countries. India’s success is well known: exports of software and business process services account for approximately 33 percent of India’s total exports. The globalization of production, with its associated fragmentation of the supply or value chain, has lowered prices and increased the variety of imported goods and services for firms and consumers. It has also led to unprecedented interlinkages and interdependency among countries. As a group, developing countries are now a major driver of global trade. Many countries have benefited greatly from global integration (Cattaneo, Gereffi, and Staritz 2010). Notably, no country in the last 50 years has sustained high levels of growth and significantly increased per capita incomes without greatly expanding trade and investment. The most dynamic countries have attracted large FDI inflows and are integrated into global value chains, often on the basis of strong regional integration. Indeed, regional integration is another reality that is fast reshaping the world. Transoceanic integration in the post–World War II period was followed by North-South integration beginning in the 1970s. Today, there is a very swift trans-Eurasian integration under way in the supracontinental space anchored by the EU, Russia, China, Japan, and India, as well as an emerging trans-Pacific partnership.

25. *The Deauville Partnership has been launched against the backdrop of an Arab world undergoing a process of change that has not been reaping the benefits of the globalized world economy.* Although countries in the MENA region, especially Partnership countries, have made progress in recent years in exploiting their comparative advantages, the MENA region’s share in total world exports of non-oil goods has remained flat at around 2 to 3 percent for more than 30 years.

Despite doubling its services exports, the region has seen its share in total services trade also stagnate at about 2.8 percent during the period from 1990 through 2006 (Chauffour 2011). These outcomes reveal serious competitiveness issues and suggest that countries in the MENA region have so far been less successful than countries in other regions in using trade as a means to create jobs, increase per capita incomes, and diversify their economies. Excluding petroleum exports, the MENA region, with over 400 million people, exports roughly the same amount as Switzerland. In particular, intra-regional trade in MENA has not taken off. For many Arab countries, regional trade accounts for less than 10 percent of total trade. At less than 5 percent, the Maghreb countries had the lowest share of intra-regional non-oil merchandise trade. And this share has increased only marginally since 2000.

26. *Similarly, while FDI inflows have surged in a number of MENA countries in the 2000s, especially in Jordan, Lebanon, and a number of GCC countries, this increase started from a very low base.* FDI inflows represent on average slightly above 1 percent of gross domestic product (GDP) in MENA countries, compared to around 3 percent of GDP in Asia, Latin America, or Eastern Europe and Central Asia. Furthermore, FDI inflows in the MENA region are concentrated in the real estate and mining sectors. FDI in manufacturing—the type of investment richest in employment—has remained marginal, accounting for just a fifth of all FDI inflows in the region. MENA’s trade and investment underperformance is particularly striking for intra-industry and intra-regional trade, the fastest-growing segment of global trade. Poor households and communities in lagging areas continue to confront major challenges in dealing with external shocks and rising food costs and in harnessing the opportunities offered by a more open world trading system. An Arab factory of integrated supply chains and production networks akin to Factory Asia has yet to emerge in the MENA region.

27. *Notwithstanding the overall trade and investment performance lag of the MENA region, Jordan, Morocco, and Tunisia have been quite successful at growing their exports in the 2000s.* Relative to potential, these three Partnership countries (together with Bahrain and the United Arab Emirates) have been the top achievers in the MENA region. Their performance is on a par with that of the successful emerging economies in Asia (e.g., Malaysia), Africa (e.g., Mauritius), and Latin America (e.g., Chile), although from a much lower export basis. In contrast, Egypt has not been able to reach its potential despite some opening and liberalization of its economy and the implementation of market-oriented reforms. Jordan, Morocco, and Tunisia have managed to expand their exports of existing products to existing markets (the intensive margin) and have also expanded to new markets (the extensive margin). However, they have not had much success in expanding exports of new and more sophisticated products (the quality margin). The productivity and sophistication of Partnership countries’ exports is estimated to have increased only moderately since 1990. Yet even Jordan, Morocco, and Tunisia, despite their relatively good export performance, have been able to penetrate only a fraction of their potential markets. This points to competitiveness challenges with respect to product quality and the overall efficiency of the trade and logistics infrastructure needed to bring those products to potential customers (Racine 2011).

28. *The mixed economic performance of the past is due in large part to halfhearted domestic reforms and the capture of benefits by a few.* When an economic opening is not accompanied by domestic reforms to promote competition and transparency in the domestic market, by the reallocation of factors through market flexibility, and by the adjustment of relative prices, the effect is often to

displace rents rather than reduce them. Under such circumstances, the gains from economic liberalization can be captured by a well-connected few. In the same vein, the benefits of economic opening cannot be fully reaped if the design and governance of public policies, including sectoral policies, distort economic decisions and stifle competition. A new integration strategy through trade and FDI should therefore show a clear break from the past. Such a strategy will need to confront political and political economy challenges, both from vested interests that benefit from markets not open to greater competition and from groups that have an instinctive resistance to inward FDI and greater imports. It should only support public policies that are designed and governed to foster growth and welfare (Aghion et al. 2011). The road ahead is promising—provided that the mistakes of the past are not repeated. Special attention should be given in the new strategy to promoting equity of opportunities so that the reform process benefits, and receives support from, the overwhelming majority of citizens.

29. ***As the trade and FDI landscape has evolved considerably in the last two decades, so have the instruments of trade and investment policy making.*** Entering into global value chains requires considerable competence on the part of suppliers and a capacity to cost-effectively move goods—and, increasingly, services—multiple times across borders to where they are needed, according to tight manufacturing schedules. This is well illustrated by the far-flung production chain of the iPod. This new trade in tasks and exchange of intermediary goods makes traditional trade policy instruments of tariff and nontariff barriers more self-defeating than ever and of diminishing utility as instruments of industrial or economic development policy (Harrison and Rodríguez-Clare 2010). Many successful emerging countries have drastically reduced their level of protection, and tariffs are no longer the centerpiece of the policy debate. What matters today for success are just-in-time manufacturing practices, efficient trade facilitation, high-quality logistics and trade infrastructure, modern administration, and easy access to trade finance. If component exporters cannot get credit, then assemblers cannot get parts, and the production cycle is interrupted.

30. ***The international trading system also faces new, long-term questions. Climate change in particular poses major challenges of mitigation and adaptation for developing countries.*** There are likely to be important consequences for patterns of production and trade in agricultural products and for food security, especially in the MENA region. Climate-related policies may have implications for trade, especially if they involve restrictions in the flow of goods and services. Trade also offers opportunities to adapt to a changing climate, including through acquisition and use of new technology, and to contribute to mitigating its effects, for instance by substituting renewable energy, such as solar, for fossil fuels—a step that could have important consequences in the MENA region.

31. ***Developing country policy makers now confront a more complex trade agenda: international trade negotiations increasingly revolve around behind-the-border regulatory policies, which are often domestic in nature.*** Trade success is increasingly determined by factors such as low internal transaction and transport costs and efficient access to quality services inputs (Djankov, Freund, and Pham 2010). In a world where traditional barriers to trade have diminished, the emphasis now shifts to ensuring that domestic policies and rules in the areas of norms and standards, trade facilitation, investment regime, competition policy, government procurement, intellectual property, and other areas correspond to best international practices. The fragmentation of production and the emergence of new services trade require the adoption of new regulatory policies affecting the movement of factors of production and market

competition in service sectors. Increased economic interdependence is generating more demands for regional and global coordination and the delivery of transnational public goods such as trade corridors. Increased exchange among peoples tends to challenge deeply rooted societal norms such as those governing labor rights, women's rights, or other human rights.

32. ***One implication of the global trends and the experience of Partnership countries with past reforms is that the trade and investment policy agenda increasingly goes beyond the traditional domain of trade ministries to include many domestic behind the border policies and regulations.*** A corollary is that this new agenda spans a wide range of policy areas that are the responsibility of other parts of government, including a variety of regulatory agencies (Chauffour and Maur 2011). These bodies do not always consider the trade repercussions of their actions. The challenges of assessing and understanding this impact, identifying possible modalities for international cooperation to reduce trade costs without undermining regulatory objectives, and obtaining a national consensus on policy reforms that will support larger, more integrated markets can be daunting for any country, but especially for developing countries with limited administrative capacity.

33. ***Openness brings opportunities, but also potential inequalities and vulnerability to global shocks.*** Globalization creates immense opportunities for countries to leverage global demand for goods and services, but the benefits are not necessarily distributed equally, either across countries or within them. It allows countries to benefit from knowledge and technologies that have been developed anywhere in the world, whether in the form of machinery, intermediate goods, FDI, or people. At the same time it greatly increases the need for governments to ensure that citizens are able to benefit from these opportunities: workers must be able to acquire the needed skills, firms need to access credit to finance profitable investment opportunities, and farmers need to be connected to markets (Hoekman and Porto 2010). Greater openness also increases the vulnerability of countries to global shocks. This has potentially major adverse consequences for the poorest households that do not have the savings needed to survive a period of unemployment or sharp falls in the prices of their outputs (and thus their incomes) resulting from global competition. The recent financial crisis demonstrated the importance of complementing greater openness with domestic policies and mechanisms to help poor households (Haddad and Shepherd 2011). Commodity markets are experiencing strong and sustained demand from developing countries, especially China. Price prospects looking forward are strong in energy and agricultural markets alike. Although this is good news for commodity exporters, for agricultural commodity importers food insecurity could have severe implications for their populations, particularly among the poor.

34. ***In facing and adapting to this rapidly changing trade and investment landscape, Partnership countries have all recognized and emphasized the importance of a new comprehensive approach to trade and investment in their competitiveness and development strategies.*** Trade and investment were at the core of the countries' action plans submitted at the G8 Finance Ministers' Meeting in Marseille in September 2011 to boost inclusive growth, employment, and productivity (Box 2).

## **Box 2. Trade and investment promotion, a cornerstone of Partnership countries' action plans**

Egypt, Jordan, Morocco, and Tunisia each submitted an action plan at the G8 Finance Ministers' Meeting in Marseille, France, in September 2011. These plans are adapted to the countries' economic and political contexts and development objectives. Inclusive growth to boost employment, investment, and productivity is at the core of all four action plans, with an explicit trade component. While these plans are likely to be refined by the governments that have taken office since September 2011 in all Partnership countries, their broad focus on inclusive growth and employment is likely to remain unchanged.

### **“Egypt, the Way Ahead: Facing Current Challenges and Building for the Future”**

Egypt's priority areas in its medium-term policy program under the Deauville Partnership are sustainable growth, job creation, trade facilitation, and investment promotion, all to be pursued through regional and global integration. The program focuses on fostering investment through business-friendly policies and public investments. Public investments will be accelerated under public-private partnerships and build-operate-transfer arrangements, particularly in projects with the highest developmental and social returns.

At the trade level, Egypt is seeking opportunities to increase its exports in G8 markets and extend the Qualifying Industrial Zones (QIZ) umbrella to new areas. Egypt considers it crucial to associate trade facilitation with investment promotion and improved domestic market institutions and trade infrastructure in order to avoid supply bottlenecks and inflationary pressure.

### **“Jordan: The Way Forward: Country Action Plan”**

Jordan's economic development program identifies enabling the investment environment, including for investment in industry and trade, tourism, and agriculture, as one of its seven priority pillars (along with social welfare, employment, education, infrastructure upgrade, financial reforms, and judicial reforms). Specifically, to bolster industry and trade, Jordan seeks the revision and simplification of rules of origin with the EU and other partner countries. Jordan also seeks to conclude the single regional convention on Pan Euro-Mediterranean preferential rules of origin with the EU. While the majority of Jordan's free trade agreements (FTAs) contain services liberalization rendezvous clauses, only the Jordan-US and Jordan-Singapore FTAs contain a services chapter along the lines of the WTO's General Agreement on Trade in Services (GATS). In this respect, Jordan is seeking to advance in the liberalization of services with the EU through the signature of the Protocol on Trade in Services. Jordan is looking for further trade liberalization through the signature of regional and bilateral trade agreements.

The Jordan program emphasizes that trade partner countries are to assist Jordan in addressing the barriers that impede the entry of its products into international markets. This is to be achieved through twinning projects and a capacity-building exercise for industrial production and product standard criteria. Jordan additionally stressed the importance of facilitating the movement of business people into international markets, given the contribution this can make to enhancing trade, business, and investment relations. Jordan seeks support from the Deauville Partnership through (a) loan guarantees; (b) partnership and investment in venture capital funds; and (c) partnerships and investment facilitation in key development projects

### **“Moroccan Plan for the Deauville Partnership”**

Morocco aims to achieve growth of 6 percent per year to reduce unemployment, eradicate poverty, and improve economic and social welfare. Morocco's expectations from the Deauville Partnership are (a) short-term support to preserve and consolidate the macroeconomic framework, including direct budgetary support, in particular to mitigate the impact of higher subsidization costs and deterioration of external balances by establishing compensatory facilities and creating a stabilization fund; (b) medium- and long-term support to bolster growth and further job creation through different forms of financing and technical assistance; and (c) support implemented

through a new approach that ensures efficiency by aligning donor intervention with country systems and harmonizing donor intervention to avoid duplication of tasks, reporting, and procedures.

At the trade level, the Deauville Partnership should help remove obstacles to increased trade, promote measures to ensure trade facilitation, and participate in the restoration and consolidation of external balances and development in general. Morocco seeks the removal of tariff and nontariff barriers to take full advantage of existing FTAs. For industrial goods, trade is restricted by rules of origin and restrictive standards. Agricultural trade is hampered by quantitative and qualitative limitations (quotas, schedule, pricing regimes to entry, and nontariff barriers such as sanitary and phytosanitary standards). Trade in services is hampered by inadequate recognition of qualifications and skills in the movement of labor.

#### **“Tunisia: Economic and Social Program: The Jasmine Plan”**

Tunisia’s top priority in its economic and social program is to tackle unemployment, particularly among graduates in the less-developed regions, through investment programs. At the trade level, Tunisia aims to advance its integration into the world economy. This is identified as one of the 10 strategic targets in the medium-term economic and social program. Specifically, Tunisia is seeking to obtain advanced status with the EU and to expand FTAs with its main trading partners. Tunisia is also seeking to become an investment hub between Europe, Africa, the Middle East, and Asia.

In the Ennahda party’s economic and social program, key trade and investment priorities are to increase the share and contribution of export in the economy; upgrade the legal and administrative framework for international trade; diversify the economy by strengthening trade policy and representations abroad; promote trade in services, especially toward the African, Arab, Asian, and American markets; extend FTAs to countries in Asia and in the Americas; and consolidate trade among Maghreb countries through FTAs.

### **3. IMPROVING MARKET ACCESS AND REGULATIONS**

35. *The ability of the Partnership countries to use trade and FDI to advance their development objectives and increase employment depends in part on the market access conditions that confront their exports and on the policies affecting their imports of goods and services.* On both fronts, the Deauville Partnership could help lower trade and investment costs, spur economic growth and employment, and promote the economic integration of Partnership countries at both the regional and global levels. Rules and discipline are key to market access opportunities that are predictable, transparent, and nondiscriminatory. There are six priorities for the Deauville Partnership in this area:

- Improve market access for **agricultural products** and encourage investment to upgrade sanitary and phytosanitary (SPS) standards, promote agricultural research and extension, and deliver efficient irrigation services.
- Reduce tariffs on **manufactured goods**; streamline unnecessary nontariff measures to reduce trade compliance costs, red tape, and discretion; adopt simpler and more liberal rules of origin in preferential trade agreements; and upgrade industrial norms and standards, testing, and certification procedures.

- Enable *services trade* to move up the value chain by fostering services liberalization and regulatory reforms, improving regional connectivity and cooperation, and supporting the presence of global services providers.
- Promote *solar energy* exports, including through a multilateral agreement on concentrated solar power; upgrade and expand infrastructure to increase electricity capacity and synchronize power grids; and open up and encourage nondiscriminatory, transparent, and predictable access to national transmission systems.
- Formulate comprehensive *labor mobility* strategies and open a sensible dialogue on ways to achieve a mutually beneficial increase in labor mobility through new mobility schemes, especially for less-skilled workers, based on an incentive-compatible design under the principle of shared responsibility.
- Promote the process of institutional changes through policy and *regulatory convergence* of technical norms and standards and other behind-the-border regulations related to competition policy, government procurement, and other trade- and FDI-enhancing aspects of the regulatory environment.

## AGRICULTURE

36. *One sector where such reforms could have an early impact on jobs is the agriculture sector.* The agriculture sector is highly strategic and at the center of equity and food security concerns in all Partnership countries. The sector is much more significant in terms of employment, regional development, and poverty alleviation than its share in GDP would suggest (Table 1). Despite severe water constraints, all Partnership countries (perhaps with the exception of Libya) have a comparative advantage in producing fruits and vegetables—provided that market access, domestic institutions, and regulation, including in the area of water management and SPS standards, allow for efficient marketing chains. Across the region, the modern horticulture sector is becoming a key force for market-oriented reforms. In Morocco’s El Guerdane project, for example, export farmers are driving private participation in development and management of an irrigation scheme. To significantly reduce rural poverty, farming efficiency needs to improve beyond these market niches, and rural populations need to move toward higher productivity and income and higher-wage activities. This could be achieved by improving incentives faced by farmers, creating the conditions for competitive agriculture and the emergence of nonfarm income activities to diversify the rural economy, and by providing rural people with critical supports, such as education, health, and information, that can help them take advantage of the economic opportunities available (Anderson 2009).

**Table 1. Role of the agricultural sector in selected MENA countries**

Indicator	Egypt	Jordan	Libya	Morocco	Syria	Tunisia	MENA (dev.)	Middle income	World
Agriculture, value added (% of GDP)	14.0	2.9	-	15.4	-	8.0	-	9.8	3.2
Manufacturing, value added (% of GDP)	15.8	19.3	-	15.3	-	18.0	-	20.4	16.4
Food, beverages and tobacco (% of value added in manufacturing)	17.8	23.7	-	19.7	-	17.3	-	-	-
(% of GDP)	2.8	4.6	-	3.0	-	3.1	-	-	-
Rural population (% of total population)	57.2	21.5	22.1	43.3	45.1	32.7	42.0	51.5	49.1
Employment in agriculture (% of total employment)	31.6	3.0	-	40.9	19.1	-	29.7	35.2	-

Source: World Bank, 2011.

Note: Data refer to 2010, except for Food, beverages, and tobacco, which refer to 2006.

37. ***The Deauville Partnership has a potential role to play in improving market access for Partnership countries' agricultural products and encouraging investment to upgrade SPS and other standards and facilities, as well as to modernize agriculture production.*** This would involve opening or relaunching negotiations to achieve complete liberalization of trade in agricultural, processed agricultural, and fisheries products between the Partnership countries and their main Deauville trading partners, including progressive abolition of tariff-rate quotas (graduated tariff levels depending on the total amount of exports), reference prices (minimum prices at which products can be exported), seasonal import restrictions, domestic and export subsidies, and other nontariff barriers to agriculture trade. In relation to the EU, the objective would be to establish a single Euro-Mediterranean market for trade in agriculture over the medium term, including for fruits, vegetables, and olive oil. It would also involve a scaling up of the Deauville partners' technical assistance and other capacity-building efforts to support Partnership countries in the adoption of the provisions and principles of the World Trade Organization's SPS Agreement and corresponding rules and procedures on SPS matters and animal welfare from Deauville partners, focusing on mutually agreed reform priorities. In the area of marketing, Deauville partners could facilitate the development of marketing partnerships to help farmers and their associations, agroprocessing companies, wholesalers, and transporters strengthen the quality, predictability, and speed of supply, especially of fresh fruits and vegetables. Deauville partners could also scale up their programs aimed at rural development, promoting investment in agricultural research and extension and public-private partnerships to increase investment in the delivery of efficient irrigation services.

38. ***Partnership countries have a largely unfinished reform agenda to promote and liberalize their agricultural sectors, as well as a strategic agenda to address regional pockets of endemic poverty, national food security concerns, and rural development challenges.*** In collaboration with farmer and private sector organizations, Partnership countries should identify constraints to agricultural trade and investment and remove bottlenecks in domestic and export marketing chains with a view to improving the rural investment climate. This would entail gradually liberalizing the sector by phasing out tariff and nontariff barriers on a most-favored-nation (MFN) basis, analyzing the opportunity costs of investing in cereals production (given the water scarcity in all Partnership countries), and considering investment in logistics and the use of modern risk management tools and financial instruments (hedging, futures, and others) to manage exposure to fluctuations in the world price of wheat and other staple foods (Minot et al. 2010). Important complementary reforms include strengthening water resources management, including better service delivery and maintenance and incentives to avoid overextraction and water wastage, and expanding public investment in agricultural research and extension, irrigation

schemes, and market information systems. In the medium term, Partnership countries could reform water regulations to assign water rights, improve cost recovery and maintenance, expand private investment in irrigation and drainage, and introduce pricing for more efficient agricultural water use. There will also be a need to encourage investment to capitalize on comparative advantages, which is best done by phasing out agricultural price supports, perhaps with the temporary introduction of farm support decoupled from production, as successfully done in Turkey and Mexico. Such an approach would benefit from complementary actions that increase the efficiency and targeting of safety net programs, such as the introduction of conditional cash transfer programs. This would reduce the very high levels of demand associated with universal food subsidies. These reforms would allow agricultural policy instruments to concentrate on sector modernization objectives.

#### **Agriculture: Key selected recommendations**

Short-term:

- **Improve Partnership countries' access to the agricultural, processed agricultural, and fisheries markets of Deauville partners, particularly for fruits, vegetables, and olive oil. Steps should include progressive abolition of quotas, reference prices, seasonal restrictions, domestic and export subsidies, and other nontariff barriers to agriculture trade.**
- Scale up EU and other Deauville partners' technical assistance and other capacity-building efforts to support Partnership countries in the adoption of the provisions and principles of the WTO SPS Agreement and corresponding rules and procedures on SPS matters and animal welfare in Deauville partners, focusing on mutually agreed priorities.

Medium-term:

- **Expand Partnership countries' public investment in agricultural research and extension, irrigation, plant protection services, and market information systems.**
- Open up the agriculture and fisheries sector in Partnership countries by phasing out tariffs on an MFN basis and limiting nontariff barriers to those necessary for food and plant safety, consistent with the WTO SPS regulations.
- Reform Partnership countries' water regulations to clarify water rights, improve cost recovery and maintenance, expand private investment in irrigation and drainage, and create incentives for efficient use of agricultural water.

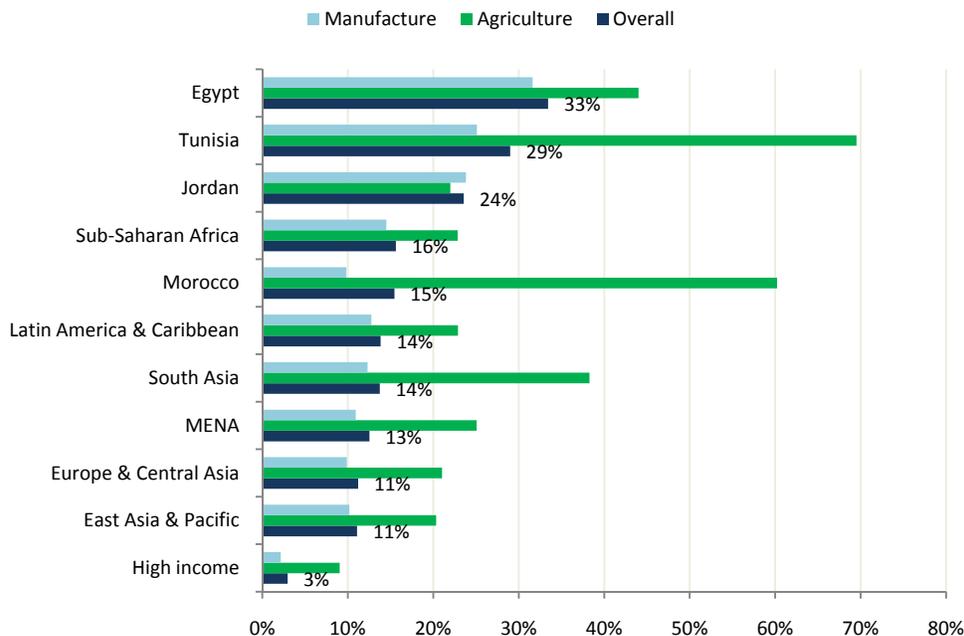
## **MANUFACTURING**

39. *Regarding trade in manufactured goods, the situation is quite different from that of agricultural trade: external markets are usually wide open, and the agenda is therefore mostly domestic.* G8 countries (and by extension Turkey, in the context of its customs union with the EU) have low external tariffs on manufactured goods. As part of PAFTA, the GCC market is also quite open to Partnership countries. The main issues faced by Partnership countries in terms of opportunities to access developed countries' markets relate to the rules of origin applicable under different preferential trade agreements and conformity with technical norms and standards to ensure the protection of human health and safety and the environment. Partnership countries would benefit if the EU were to move to simpler and more liberal rules of origin in preferential trade agreements, including the adoption of a simple value-added criterion and full cumulation of rights across all MENA countries with EU trade agreements. The proposed regional convention on preferential Pan-Euro-Mediterranean rules of origin

that allows for cumulation and single transformation to qualify for preferential treatment could be further improved and made consistent with the rules implied by the EU agreements with accession countries. Partnership countries would also benefit from a scaling up of the various existing technical assistance and capacity-building programs to upgrade their regulations, standards, and testing and certification procedures in line with best international practices.

40. *In contrast to advanced economies, market access in the MENA region is quite restrictive, particularly for exporters from Latin American and Sub-Saharan African countries.* Notwithstanding the progress made in the last decade in reducing tariff rates, the overall level of tariff and nontariff protection in the MENA region vis-à-vis the rest of the world remains relatively high by international standards, especially for agricultural products (Figure 2). In particular, the region compares unfavorably with its main competitors in Eastern Europe and Central Asia, Latin America and the Caribbean, and East Asia and the Pacific—the new dynamic poles of the world economy.

Figure 2. Overall Trade Restrictiveness index by region, 2008



41. *In addition, as in all regions, nontariff measures (NTMs) have become important barriers to trade in the MENA region—and not always for the purpose of protecting human health and safety or the environment.* In the region, the existence of NTMs has had the particularly perverse effect of complicating reforms of the subsidy systems. Available econometric studies suggest that the gap introduced by NTMs between domestic and world prices is typically large in Morocco and fairly large in Tunisia. When NTMs are included in the calculation of overall trade restrictiveness (Kee, Nicita, and Olarreaga 2009), the MENA region comes across as quite restrictive as compared to other regions, driven by high NTMs on agricultural goods. Progress has been made in streamlining NTMs over the last decade. Indeed, their composition has changed with the reduced use of command-and-control

instruments (such as quantitative restrictions, prohibitions, and anticompetitive measures) and the emergence of technical regulations. But reforms have remained partial—from the adoption of technical improvements in border management without a change in enforcement culture to the creation of dialogue structures that remain largely empty shells for lack of political drive.

42. ***Looking forward, Partnership countries should continue to unilaterally reduce their MFN tariffs, especially tariff peaks and dispersion. Such unilateral liberalization has proven to be a successful strategy in a number of emerging countries.*** As noted in section 2, tariff protection is an increasingly self-defeating proposition in a multilateral trading system characterized by the fragmentation of production along value chains. Indeed, it is often observed that in East Asia—the region that has been most successful at harnessing trade for growth and employment—intra-regional trade was driven not by preferential trade agreements but by unilateral trade policies and by firms responding to global opportunities. A reasonable objective for Partnership countries would be to gradually move to MFN rates not exceeding 5 percent in the medium term—the actual level of preferential tariff within PAFTA. This would have the additional benefit of reducing the risk of trade diversion caused by the difference between MFN and preferential rates.

43. ***In parallel, Partnership countries should streamline unnecessary NTMs in order to reduce trade compliance costs by avoiding unnecessary stringency, reduce red tape by streamlining procedures, and increase predictability and transparency.*** Practically, NTM streamlining involves two tasks: (a) reviewing existing measures with the aim of eliminating the most inefficient ones (including through the so-called “guillotine” approach) on the basis of careful cost-benefit analyses, and (b) establishing effective good governance structures for new measures. International institutions (e.g., the WTO or the Organisation for Economic Co-operation and Development) or regional agreements (e.g., NAFTA or ASEAN) could provide the necessary rule-setting process for distinguishing product regulations from NTMs.

44. ***For Partnership countries, either the Agadir agreement or PAFTA could become the framework for identifying, reviewing, and streamlining existing NTMs; moving toward regional harmonization and/or mutual recognition in selected areas; and establishing good regulatory practices, including the institutionalization of regulatory impact assessments (RIAs) and the creation of regulatory oversight bodies.*** There is no fixed scientific formula behind the RIA acronym, but rather a list of steps—essentially asking common-sense questions—to improve the process through which NTMs are created. This involves two types of challenges. The first is institutional: different agencies must be induced to coordinate through a complex process based on transparency and economic rationality. The second is analytical. An RIA is a difficult exercise requiring administrative capabilities that are unlikely to be readily available in Partnership countries. International institutions such as the World Bank could provide targeted technical assistance when country capabilities are initially low.

45. ***In the long run, Agreements on Conformity Assessments and Acceptance of industrial products (ACAAs) and mutual recognition agreements (MRAs) are key ways of harmonizing industrial standards across countries and reducing the market fragmentation effect of NTMs, especially technical regulations.*** These agreements would ensure that Partnership countries have state of the art product quality, labeling, packaging, and traceability standards. But ACAAs and MRAs

require a high degree of cooperation and confidence between national regulatory systems, which typically happens between countries with similar income levels or in the context of deep integration, such as common markets. A greater integration of Partnership countries with the EU and the United States (i.e., through DCFTAs and MENA TIP) and with other developed countries and Turkey would offer significant opportunities in this area.

#### **Manufacturing: Key selected recommendations**

Short-term:

- **Strengthen private-public partnership structures or mechanisms in Partnership countries to review, monitor, and streamline regulatory impediments to the business environment (e.g., NTMs) and conduct market surveillance. Examples include Morocco’s National Committee on Investment Climate (CNEA) and the Egyptian Regulatory Reform and Development Activity (ERRADA).**
- Negotiate mutual recognition agreements, such as Agreements on Conformity Assessment and Acceptance of industrial products, between Partnership countries and Deauville partners to reduce the market fragmentation effect of technical barriers to trade. This is especially relevant in priority sectors that account for a large part of Partnerships countries’ exports, such as mechanical and electric industries and construction materials.
- Scale up the EU and other Deauville partners’ technical assistance and capacity-building programs to upgrade the technical regulations, standards, testing, and certification infrastructure and procedures in Partnership countries in line with best international practices.
- Adopt and implement simpler and more liberal rules of origin in preferential trade agreements between Partnership countries and Deauville partners, including an improved EU regional convention on preferential Pan-Euro-Med rules of origin.

Medium-term:

- **Open up the manufacturing sector in Partnership countries by gradually reducing MFN tariff rate levels and dispersion on manufacturing goods to the level of key competitors in emerging markets.**

## **SERVICES**

46. *Services are major inputs in any kind of economic activity. Partnership countries need access to high-quality, efficient, and moderately priced services in order to move to the next stage of integration.* This is one of the key conditions for becoming more competitive in domestic and foreign markets and participating more actively in global production networks (Cattaneo et al. 2010). This greater integration could take the form of the direct export of services or the indirect role of so-called “backbone services,” namely transport, telecommunications, finance, and energy, in expanding the export base for manufactured goods. To a large extent, the services trade potential of Partnership countries remains untapped, notwithstanding a rapid growth in recent years, especially in transport and tourism, and a net services trade surplus. A further diversification of services supply is desirable to reduce the dependence on a few vulnerable sectors. Given their comparative advantages (including skills and geographic location), Partnership countries have strategic trade interests in information technology-enabled services, business services, and professional services, among others. However, with the prevalence of intra-firm and intermediate services trade, Partnership countries are unlikely to become major services exporters in those sectors unless they further open their own markets. Foreign

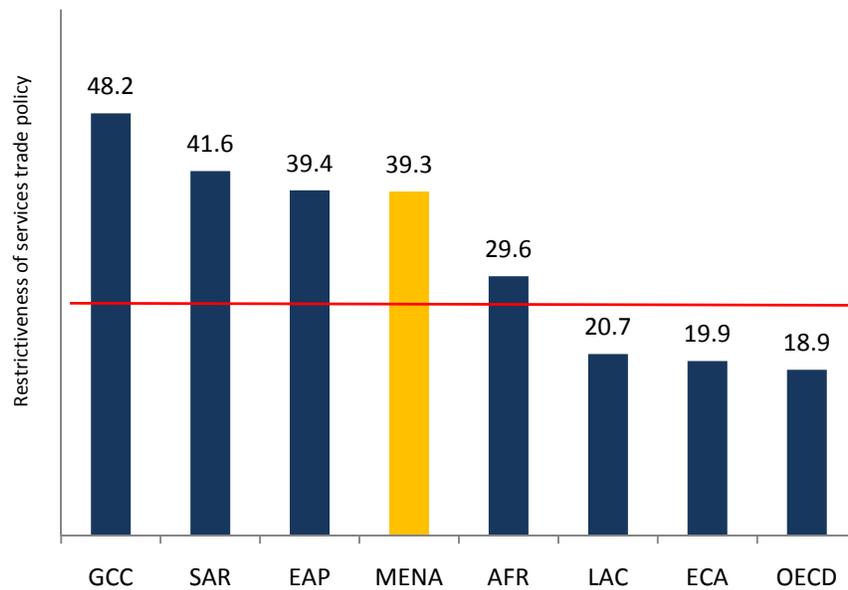
establishment and the movement of service providers in particular are key factors of technology and knowledge transfers.

47. ***The objective for the Partnership countries should be to use services trade to move up the value chain.*** Deeper integration with selected G8 partners could help them join production platforms with intermediate goods and services traded within free trade areas, thus developing a competitive position vis-à-vis the rest of the world. The issue is not competing with China and other emerging countries, but rather offering a bundle of tasks with high-value-added content at key points in global value chains. Beyond the economics, the development of services trade has important social dimensions that should be taken into consideration when designing domestic regulatory reforms and regional trade integration strategies. These include the gender, employment, and spatial/regional planning dimensions. Especially in countries in democratic transitions, where inequalities have caused social distress in recent years, those dimensions should guide reform priorities for the G8 and Partnership countries.

48. ***Despite numerous initiatives and declarations of intention, the MENA region remains relatively insulated from global services markets.*** MENA services trade is among the most restricted in the world, especially in the GCC countries (Figure 3). The region suffers from a triple gap:

- ***An openness gap.*** The MENA region is one of the least open in the world. Regulatory restrictions on all four modes of services supply (i.e., cross-border trade, consumption abroad, commercial presence, and presence of natural persons) constitute a major obstacle to regional integration and to the participation of the region in the new division of labor allowed by the globalization of production. The levels of commitment in the WTO's General Agreement on Trade in Services (GATS) vary noticeably from country to country but remain low on average, and the offers currently on the table are far from ambitious. Countries that recently acceded to the WTO and/or negotiated FTAs with G8 countries are best positioned.
- ***An integration gap.*** The integration of services markets in the region lags far behind the progress that has been achieved for goods, for instance within PAFTA, where most tariffs and duties on intra-regional trade have been removed. Most of the gains expected from further integration and a removal of the barriers to trade still lie ahead. This is true both for horizontal (South-South) and vertical (North-South) integration: in both cases, negotiations are still under way and should be concluded as soon as possible.
- ***A performance gap.*** The openness gap results in poor performance of the Partnership countries' services providers, except in the tourist industry. Yet even tourism receipts and prospects have suffered from the region's turmoil. The attractiveness for services offshoring has also dropped. Thus, there is an urgent need to further diversify the Partnership countries' services supply to sustain growth and employment in the region.

Figure 3. Services Trade Restrictiveness Index, 2007–08



49. *To promote services trade and investment to the mutual benefit of the G8 and Partnership countries, the Deauville Partnership could consider a three-pronged approach:*

- *First, foster liberalization and regulatory reforms, including through deeper services integration in the context of high-quality trade agreements with Deauville partners.* This would involve a number of phases, starting with the preparation of a diagnostic study of competition, regulation, and market access conditions prevailing in Partnership countries. Deauville partners could provide technical assistance support, including to build public platforms for dialogue and coordination and to improve services trade statistics and capacity within relevant ministries and institutions (including negotiation skills). Part of the services strategy would be to identify the sequence and optimal level of reforms. Partnership countries should assess the contestability of their markets and improve the competition framework before opening. They could also consider a parallel exercise to liberalize services trade among themselves in the context of the Agadir agreement. Partnership countries would also benefit from adopting a pragmatic approach to the sensitive matter of the temporary movement of services providers in the region. The Deauville Partnership could facilitate the dialogue with a view to developing mutually acceptable standards and criteria for licensing and certification of professional services suppliers on the basis of factors such as educational background, qualifying examinations, and experience.
- *Second, improve regional connectivity and cooperation through the creation of hard (infrastructure) and soft (institutions) networks.* With the coordinated assistance of the G8 and Deauville partners, Partnership countries could develop regional infrastructure for telecommunications, energy, transport, and other backbone services. This could take the form of

strengthened cooperation among services regulatory agencies or/and the creation of joint agencies where appropriate.

- **Third, enhance the competitiveness and export performance of Partnership countries.** Partnership countries, with support from G8 and other donors, would benefit from adopting accompanying measures aimed at improving the competitiveness and global presence of their services providers. This involves efforts in the areas of education and training, business environment, protection of intellectual property rights or data, procurement rules, etc.

#### Services: Key selected recommendations

Short-term:

- **Modernize the regulatory regimes of the key services sector in Partnership countries (e.g., trade facilitation and transport, including air services, energy, tourism, banking and finance, and information and communication) consistent with best international practices.**
- Negotiate between Partnership countries and Deauville partners specific sectoral commitments on labor mobility, especially for skilled workers, as part of Mode 4 on the movement of natural persons in future deep and high-quality trade agreements with Deauville partners.

Medium-term:

- **Open up the services sector in (and between) Partnership countries in all four modes of services supply beyond the GATS commitments, including in the context of deep and high-quality trade agreements with Deauville partners and mutually agreed priority services sectors.**
- Negotiate acceptable standards and criteria for licensing and certification of professional service suppliers on the basis of factors such as educational background, qualifying examinations, and experience with a view to agreeing on mutual recognition of qualifications and skills and portability of benefits in future deep and high-quality trade agreements with Deauville partners.
- Develop regional (soft and hard) infrastructure for telecommunications, energy, transport, and other backbone services in Partnership countries to improve regional connectivity and cooperation, including cooperation among services regulatory agencies or/and the creation of joint agencies where appropriate.

## ENERGY

50. **Reliable access to efficient energy services is a key precondition for sustaining economic growth.** Energy is a critical factor of production in the agriculture, mining, and manufacturing sectors. It is a source of investment and therefore a direct contributor to economic growth and growth potential. The efficiency with which energy is used in the economy also has indirect effects on total factor productivity. From the perspective of trade and FDI, improved access to reliable and efficient regional energy markets is another powerful mechanism of economic integration that can help accelerate economic growth and employment. Regional integration and trade in the power sector can both help MENA countries meet energy demand and improve the security of supply.

51. **The MENA region has a strong comparative advantage in energy resources—both traditional and renewable.** The region is endowed with about 57 percent of the world's proven oil reserves and 41 percent of proven natural gas resources. It also has unique solar potential. The distribution of the oil and

gas endowment is highly unequal within the region, with some countries rich in natural resources while other countries depend on imports of such resources. With the exception of Libya, Partnership countries are mainly in the second category. Solar potential is naturally more evenly spread and offers great prospects for Partnership countries. Overall, in these countries, there is much scope for improving the efficiency of energy supply and energy conservation, as well as for developing renewable energy resources. The rest of this section focuses on electricity and gas.

52. ***Although subregional interconnected electricity networks have existed for some time in the Maghreb (among Morocco, Algeria, and Tunisia) and among eight other mainly Mashreq economies (Egypt, Iraq, Jordan, Libya, Lebanon, West Bank and Gaza, Syria, and Turkey), electricity trade among MENA countries and with neighboring Mediterranean countries has remained modest.*** Trade cannot currently take place between those subregional networks. Only three countries—Algeria, Morocco, and Tunisia—are synchronized with the EU grid. The GCC countries are unable to trade with other MENA countries because they are not physically interconnected. Although the Maghreb countries (except Libya) are fully interconnected and synchronized, transfers of large amounts of power across Northern Africa are not currently possible. At the institutional level, there is no coordination of the generation and transmission operation for the subregions, making it difficult to determine the potential for further trade. The electricity markets in Partnership countries remain mostly vertically integrated in the framework of state-owned utilities. As a result, international transactions take a long time to negotiate and are unable to respond to short-term opportunities, such as sudden changes in generation availability. Private sector participation in electricity markets is generally limited to independent power producers.

53. ***One of the most significant bottlenecks in developing new power generating capacity in Partnership countries is the supply of fuel.*** While the share of gas in power generation doubled to about 50 percent during the last decade, it will be difficult to continue to increase this share significantly in the coming years given the increased constraint on the amount of natural gas available for power generation. In particular, Jordan, Tunisia, and Morocco have realized that their domestic gas production together with their current gas imports are not sufficient to meet the needs of their power sectors. This has triggered a search for alternative energy, particularly renewable energy, as well as for sources of imported gas and/or electricity. Gas trade within the region is, however, limited to rather small volumes of gas movements from Algeria to Tunisia and Morocco; from Egypt to Jordan, Syria, and Lebanon; and from Qatar to the United Arab Emirates—all through pipelines. There is some potential to expand existing gas pipelines in the region, but the prospects for liquefied natural gas facilities for gas export seem brighter.

54. ***The solar energy potential of the MENA region offers a unique opportunity to diversify sources of energy and at the same time limit the carbon footprint of the region.*** Unlike oil and gas, solar energy is evenly spread across MENA countries—including all the Partnership countries. For oil and gas importers, renewable energy would provide energy security, whereas for oil and gas exporters it could free up fossil fuels for higher-value-added usage and exports. The prospect for exporting green energy to Europe at high prices reinforces the vision that renewable energy could become an important and reliable source of revenue for the Partnership countries (Box 3).

### Box 3. Comparative advantage, integration, and technology: Let the sun shine in

There have long been dreams of harnessing the incredible solar energy potential of the deserts of MENA, but now those dreams are becoming a reality. A “commodity” in which MENA has clear global comparative advantage is beginning to be exploited, to regional and global benefit. That development is motivated by objectives of employment creation, climate change mitigation, regional integration in the Mediterranean and GCC space, and energy security. These objectives are reflected in the Union for the Mediterranean’s “Mediterranean Solar Plan,” as well as in the DESERTEC and MEDGRID initiatives.

MENA countries from Saudi Arabia to Morocco are taking steps to scale up solar power. Strong emphasis is being placed on concentrated solar power (CSP), a highly transferable technology that could create tens of thousands of jobs in MENA over the medium term, as well as FDI opportunities. This scale-up of CSP is being supported in five MENA countries—Morocco, Algeria, Tunisia, Egypt, and Jordan—by a multidonor group. Catalytic funding is being provided by the highly concessional Clean Technology Fund, and private investment is being mobilized in partnership with the public sector.

A crucial question still being resolved is whether green energy markets in Europe will allow access to imports of CSP energy from MENA on terms equivalent to those provided to EU producers. Opening these profitable markets will be essential to the takeoff of CSP in Mediterranean MENA. It will require adoption of some implementing regulations, and ultimately some transmission investments once a high level of imports is foreseen. But the first step is for European offtakers—with government financial and political support—to commit to importing CSP. That action would have a powerful and immediate demonstration effect throughout the region, signaling that Europe is willing to open important markets to create much-needed employment and revenue in MENA.

55. *To promote electricity integration, a key priority is to improve and expand capacity and synchronize the power grids.* The necessary infrastructure improvements include reinforcement of existing cross-border interconnections and upgrading of national transmission networks. Another component involves construction of new international interconnections and expansion of generation capacity for export to other market destinations, particularly of renewable energy. A barrier to increased regional trade and cooperation as well as private sector participation in power generation has been the significant subsidization of pricing in the power sector. As in other MENA countries, electricity price distortions are large in Partnership countries, and tariffs are set below their cost recovery level. This has led to inefficient use of supply, high energy intensity in energy use, increasing environmental problems, and a rapidly increasing burden on government finances. In particular, most Partnership countries have had difficulty coping with high oil prices. This situation makes it difficult to find a creditworthy offtaker, since many power companies have poor financial performance.

## Energy: Key selected recommendations

### Short-term:

- **Launch negotiations on a multilateral agreement on solar energy imports from MENA that will govern how the parties share the burden of paying for the incremental cost of solar imports. (European subsidies for renewable energy could be made available for imports, with appropriate adjustments.) The agreement could be concluded initially between Morocco and interested EU member states, such as Germany, Spain, France, Italy, and perhaps others. Other Partnership countries could also be invited to join the agreement, depending how fast they move with CSP projects.**
- Start harmonizing (a) technical codes and standards for the national energy systems; (b) regulation in the national energy sectors; (c) goals and milestones for energy sector reform relating to, in particular, open access and consistent and fair pricing of transport; and (d) energy pricing and taxation. Identify an independent process and procedure for resolving disputes related to regional energy transactions. Modernize the regulatory regimes of the key services sector in Partnership countries (e.g., trade facilitation and transport, including air services, energy, tourism, banking and finance, and information and communication) consistent with best international practices.

### Medium-term:

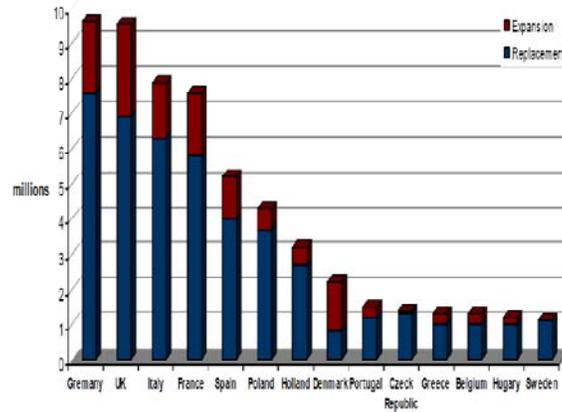
- Open up and encourage nondiscriminatory, transparent, and predictable access to national transmission systems by implementing reforms to ensure reciprocity and a level playing field governed by technical and financial documentation and high-level institutions with the expertise and authority to guide and, if necessary, enforce a level of consistency and fairness across the region.
- Upgrade and expand infrastructure to increase electricity capacity and synchronize power grids, including by reinforcing existing cross-border interconnections, upgrading national transmission networks, and constructing new international interconnections. An expansion of generation capacity in certain countries for export to other market destinations, particularly renewable energy developments, would also enhance the prospects for regional integration.

## LABOR MOBILITY

56. ***In the Mediterranean basin, labor mobility is so restricted, especially for less-skilled workers, and so politically sensitive that large opportunities for mutually beneficial exchanges are missed.*** Labor migration, which until recently was the exclusive domain of domestic immigration policy, has become central to the policy debate on economic integration and development. Indeed, nothing separates an individual from the benefits of development as much as the lack of a work visa. At the global level, there is strong evidence that labor market restrictions are imposing a much greater burden on economies than trade or FDI restrictions. In the region, the demographics of the Northern and Southern Mediterranean are particularly suitable for strong, mutually beneficial exchanges. The potential for a North-South demographic arbitrage in the Mediterranean is—at least on paper—compelling. On the one hand, most migrant-receiving countries in the EU have stagnating populations and expect their labor force to decline. Such a decline is likely to generate persistent labor market shortages at all skill levels, thereby providing an opportunity for both skilled and less-skilled migrants (Figure 4). On the other hand, most MENA countries will continue to experience significant labor force increases and an excess

supply of young workers with medium and high qualifications, which could potentially meet Europe's future labor needs.

**Figure 4. Total job openings in the EU due to replacement and expansion demand, 2006–2015**



57. *There are, however, two major stumbling blocks in the way of greater South-North labor mobility in the Mediterranean.* First, labor migration faces huge obstacles in many advanced countries due to current high unemployment rates and fierce political opposition to low-skilled immigration. In the context of the euro zone crisis and persistent high unemployment rates in European countries, especially among youth and the most vulnerable groups, domestic options are likely to prevail among European voters and their governments over policies to allow increased labor immigration. Second, young Arab workers may find it difficult to offer the skills needed to compete for jobs in advanced, largely knowledge-based economies. Not unlike in their own domestic markets, workers with secondary and tertiary education in Partnership countries seem to provide a poor skills match for private sector demand in Europe.

58. *The Deauville Partnership is an opportunity to open a sensible dialogue on the ways and means of achieving a mutually beneficial increase in labor mobility between the two rims of the Mediterranean and beyond.* Gradually liberalizing the movement of persons would complete the long-term vision of a common Mediterranean economic area with the free movement of goods, services, capital, and labor. Such an option would provide significant new opportunities for mutually beneficial exchanges, especially for less-skilled migrant workers. At the regional level, the Deauville Partnership could usefully strengthen the migration framework for increased intra-Arab labor mobility, especially to the GCC and Libya. If major progress on mobility is difficult in the near term for political reasons, then progress on the trade and investment is all the more important.

59. *However, it is in relation to the EU that a regional avenue for increased labor mobility is the most promising and attractive for Partnership countries.* To this end, the EU has offered to launch new mobility partnerships, especially for less-skilled workers, and to expand existing ones, including increased visa facilitation for some categories of peoples, readmission, and concerted border management. It could also take on specific and more ambitious commitments for liberalizing labor-intensive services under Mode 4 on the temporary movement of natural persons in future DCFTAs and

MENA TIP. At a minimum, the EU could extend to Partnership countries what it has already granted to other countries. For instance, the CARIFORUM-EU Economic Partnership Agreement signed with a number of Caribbean countries includes firm commitments on the movement of contractual service suppliers and independent professionals, something that the Euro-Med Association Agreements do not provide. The 2002 EU-Chile Agreement contains provisions on the temporary movement of business service sellers in about 30 service sectors (though skewed toward highly skilled workers). The EU could also prioritize the mutual recognition of qualification or skills and the portability of benefits in future agreements with Partnership countries. This may also require streamlining the mandates of the European Commission on migration and establishing a monitoring mechanism for cooperation between the EU, its agencies, member states, and third countries. This would allow Partnership countries to benefit from all the possibilities of visa facilitation offered by the Schengen Code for students, researchers, business people, and all other bona fide travelers.

60. *At the bilateral level, the G8 and other Deauville partners could develop new mobility schemes based on an incentive-compatible design under the principle of shared responsibility and increase bilateral cooperation for labor mobility with non-EU destinations such as Canada (especially Québec for French-speaking Arabs), Libya, and the GCC countries.* G8 countries need to overcome the primacy of the border-management approach of immigration authorities and develop a more economic and demand-driven labor market approach. Individual EU member states could further improve their migration programs for Partnership countries by drawing on the best international practices in program design and implementation and institutional capacity building. They could find inspiration in the innovative migration schemes put in place in Canada, Australia, and New Zealand. As with the concept of “aid for trade,” G8 countries could provide the financial and technical assistance to build up or strengthen behind-the-border systems to manage labor outflows. Indeed, this would seem essential for any sustainable implementation of bilateral labor mobility agreements from the receiving country perspective.

61. *On their side, Partnership countries need to formulate comprehensive labor emigration strategies beyond diaspora engagement and remittances, taking into account the highly sensitive political contexts on migration issues in receiving countries.* A first step would be to improve the implementation of existing bilateral labor mobility agreements with the main destination countries. This would involve a multipronged approach to strengthen the capacity of public agencies for job prospecting and placement of workers abroad and to enhance marketing and communication tools for labor export. For instance, the technical coordination between sending and receiving countries on skill-matching procedures and information sharing could be improved through joint missions of public employment agencies. Having an exportable and acceptable supply of migrant labor would require upgrading training and skills of would-be migrants, including soft skills, language, and information technology, as well as better screening of emigration candidates. Other possible steps would involve using embassies and consulates in G8 countries for improved job prospecting and assessing the implementation of successful migration agreements around the world with a view to improving the design and functioning of existing agreements with the EU. Over the medium term, Partnership countries need to better align educational and training priorities with the skills and competencies expected in the private marketplace.

### Labor mobility: Key selected recommendations

Short-term:

- **Improve the design and implementation of existing bilateral labor mobility agreements between Partnership countries and Deauville partners by (a) strengthening the capacities of public agencies for job prospection and placement of workers abroad; (b) upgrading training and screening of emigration candidates; (c) improving technical coordination between sending and receiving countries on skill-matching procedures and information sharing; and (d) lowering the transaction costs on firms and workers related to slow and complex administrative procedures.**

Medium-term:

- Launch labor mobility partnerships or similar mobility schemes between Partnership countries and Deauville partners, including visa facilitation for some categories of workers, readmission, concerted border management, and easier access to the job market of the Deauville partners, especially for less-skilled workers from Partnership countries.

## REGULATORY CONVERGENCE

62. *For the Partnerships countries' open trade and FDI strategy to bear fruit and be welfare enhancing, the countries must implement a set of companion policies to reform the domestic regulatory environment with a view to achieving regulatory convergence with the most advanced trading partners.* Until now, the MENA region has suffered from discretionary and arbitrary implementation of policies and from a lack of credibility in government commitments to change a deeply rooted status quo of privileges and unequal treatment of traders and investors (World Bank 2009a). A new integration strategy through trade and FDI should show a clear break from the past pattern, in which the gains from economic liberalization were often captured by a well-connected few. This requires that attention be paid to a number of behind-the-border issues, which, although not directly related to trade or investment, have great consequences for the outcome of such outward-oriented strategies.

63. *In order to reap the full benefits of greater trade and FDI integration, Partnership countries should consider accelerating the convergence of their regulatory framework with the best international practices.* Beyond the free movement of goods, persons, services, and capital discussed earlier, this would involve the gradual alignment of a number of behind-the-border regulatory issues dealing with competition, government procurement, and other aspects of what is known in the EU as the Community acquis, detailed in a list of 31 chapters focused on requirements for enlargement of the EU to include Central and Eastern European countries.<sup>6</sup> For the purpose of this report, we focus on two areas of particular relevance to a trade and FDI agenda: competition policy and government procurement.

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<sup>6</sup> These chapters cover free movement of goods, free movement of persons, freedom to provide services, free movement of capital, company law, competition policy, agriculture, fisheries, transport policy, taxation, economic and monetary union, statistics, social policy and employment, energy, industrial policy, small and medium-size enterprises, science and research, education and training, telecommunication and information technologies, culture and audiovisual policy, regional policy and coordination of structural instruments, environment, consumer and health protection, cooperation in the field of justice and home affairs, customs union, external relations, common foreign and security policy, financial control, financial and budgetary provisions, institutions, and others.

64. **Competition policy needs to become an essential complement to the trade agenda.** It goes hand in hand with consumer protection policy. Competition or inter-firm rivalry promotes innovation and higher standards and is essential to ensure that consumers enjoy freedom of choice, low prices, and value for money. Competition also erodes the rents that are the source of privilege. In Partnership countries, the business environment is characterized by the quasi-absence of effective competition policy and by a very slow process of firms' entry and exit because of high barriers to entry, limited access to finance, inadequate human resources availability, and government interventions (Sekkat 2008). With the partial exception of Jordan, their manufacturing sectors are highly and increasingly specialized in food products, wearing apparel, and textiles (Table 2). Industries usually have high markups. In Egypt and Tunisia, state-owned enterprises represent an important share of manufacturing output. This weak competitive environment in Partnership countries has survived the enactment of competition and consumer protection laws in the last two decades because of weak implementation and enforcement practices.

**Table 2. Competition and efficiency in selected Arab countries**

Country	Industry		
	Food	Textiles	Wearing apparel
	Shares in manufacturing employment (%)		
Egypt	18	23	6
Jordan	15	3	8
Morocco	18	8	35
Tunisia*	18	35	
	Four firms concentration ratio (%)		
Egypt*	54	76	
Jordan	50	78	27
Morocco	20	13	10
Tunisia*	31	30	
	Markup (%)		
Egypt	173	120	113
Jordan	176	128	100
Morocco	112	105	109
Tunisia*	119	117	
	Total factor productivity growth (%)		
Egypt	-0.05	0.01	0.03
Jordan	-0.62	0.64	0
Morocco	-2.45	2.11	-1.25
Tunisia*	0.2	0.5	

Note: \* = Textiles and apparel aggregated.

Source: Sekkat 2008.

65. **A well-designed regional competition agreement could act as a policy tool to create the national institutional and behavioral environment necessary to benefit from regional competition provisions while taking account of local realities.** Negotiating competition provisions in a future DCFTA with the EU could therefore have great development benefits, especially for Southern partners.

It could help strengthen implementation, especially if the more developed party offers appropriate technical assistance and capacity building. Given the difficulty of Partnership countries in implementing their own competition rules, a DCFTA or similar agreement with another advanced economy would help establish a culture that values competition at the national or subregional level in the region. This would create an incentive to implement national regimes with a view to creating policy lock-in, increasing FDI, gaining technical assistance, and learning by doing. Partnership countries could also consider negotiating regional competition provisions in the context of the Agadir agreement and, in the long run, expand the agreement to other members of PAFTA. These competition provisions potentially could generate beneficial regional public goods. Partnership countries working together could induce beneficial cross-border spillover effects, such as in the provision of information or cooperation in enforcing competition law in the region. Setting up competition observatories could increase public support for trade and FDI openness under strengthened competition rules.

66. ***Government procurement is another determinant of a competitive economic environment in which all economic actors—domestic and foreign—compete on a level playing field.*** To be sure, public procurement policy in all countries responds to a mix of objectives, including value for money (typically taken to mean minimizing procurement costs) but also macroeconomic management, national security, redistribution to the poor, industrial and regional development, promotion of small and medium enterprises (SMEs), and support for state-owned enterprises and their employees. Yet despite, or perhaps because of, the variety of government objectives for public procurement policy, most jurisdictions, international accords, and pronouncements of international organizations on public procurement tend to refer to a core set of four principles for the implementation of national policy in this area: efficiency (value for money); equality of opportunity to compete for state contracts (nondiscrimination); transparency (control of corruption; accountability); and encouragement of investments and partnerships (public-private partnerships). In Partnership countries, the inefficiency and opportunity cost of suboptimal levels of competition in national procurement regimes can be substantial. For an average developing country that spends about 15 percent of its national income on goods and services, a 10 percent saving on procurement contracts is equivalent to 1.5 percent of GDP—an amount that for many developing countries may exceed the total amount of aid received.

67. ***As in the case of competition policy, Partnership countries would benefit from pursuing efficient, transparent, and nondiscriminatory government procurement in the context of their regulatory convergence with the EU and other advanced economies.*** In the first instance, to promote and lock in the principles of openness, transparency, and nondiscrimination, Partnership countries could usefully join the WTO government procurement agreement. In parallel, Partnership countries could explore the benefits of negotiating government procurement provisions with their principal advanced trading partners, starting with the EU and the United States in the context of the DCFTAs and MENA TIP, respectively. The motives for negotiating and agreeing on public procurement provisions with the EU would not be limited to market access. Partnership countries might strategically accept binding rules on their national procurement regime as the most effective way of reforming national practices. Partnership countries could also initiate a similar government-procurement best practice in the context of the Agadir agreement and later on within PAFTA. Deauville partners should step up and provide the necessary technical assistance and capacity to help Partnership countries set up effective government

procurement regimes. This would require establishing specialized institutional frameworks and expertise.

#### **Regulatory convergence: Key selected recommendations**

Short-term:

- Adopt comprehensive competition legislation in Partnership countries with an effective competition agency in charge of implementation consistent with future deep and high-quality trade agreements.
- Adopt efficient, transparent, and nondiscriminatory government procurement legislation in Partnership countries, with effective implementation mechanisms consistent with future deep and high-quality trade agreements.

Medium-term:

- **Achieve a gradual regulatory convergence of the Partnership countries with the rules and regulations in place in their main Deauville partners, including through alignment with relevant WTO discipline and gradual approximation of the EU Community acquis, focusing on mutually agreed priority areas.**

## **4. FOSTERING COMPETITIVENESS, DIVERSIFICATION, AND EMPLOYMENT**

68. *An important reason that Partnership countries have not been able to enter foreign markets and save and invest in the future as much as other successful emerging economies is an overall lack of competitiveness and diversification.* Competitiveness is central to harnessing private sector growth for sustainable employment, poverty reduction, and, ultimately, wealth creation (Porter 1990). To reap the benefits of market opportunities, and for such opportunities to induce job creation, the regulatory environment for business should be improved, technological upgrading and skill availability should be fostered, and countries should boost their ability to enter new and sophisticated export markets. But firms, especially small- and medium-size ones, serving export and domestic markets in all sectors cannot exploit opportunities if they are burdened by costs outside their control that make them uncompetitive. Increasing the number and value of products produced, the number of markets served, and the survival rate of firms is conditional on lowering such costs. And partnership countries need investment now. This requires economy-wide policies and regulations aimed at creating the proper business environment and investment climate, including trade policy (restrictions on imports and FDI); trade in services as a new means to access international best practices and expand exports; and the design and implementation of specific actions to address market and information failures. There are four priorities for the Deauville Partnership in this area, including absolute priority for the recommendations aimed at attracting FDI and fostering domestic investment:

- Strengthen the *FDI regime* by phasing out de jure and de facto restrictions on foreign equity participation in most economic sectors; simplifying and rationalizing investment regimes; easing access to production factors (industrial land, foreign exchange, and expatriate workers); completing privatization programs; and launching negotiations with Deauville partners on investment.

- Improve the *domestic business climate* by fostering competition and limiting opportunities for rent seeking; building strong rule-bound market institutions to reduce discretion and opacity; and promoting new institutional dialogue among stakeholders on the design, implementation, and evaluation of policies.
- Address structural *economic governance* issues by fighting corruption, discretion, and the uneven implementation of policies; restoring voice, accountability, and checks and balances; strengthening the rule of law and the level playing field; and promoting transparency through freedom of information.
- Foster the four pillars of a *knowledge economy* by harnessing more technological spillovers from existing and future FDI; launching a major overhaul of education systems; developing comprehensive knowledge and innovation strategies; and further diffusing information and communication technologies.

## FDI REGIME

69. *There seems to be a point in the course of countries' reform processes when FDI inflows take off and trigger a virtuous cycle of pro-business reforms and economic development.* When a country offers good business opportunities, foreign investors watch and follow other foreign investors. Essentially success breeds success. The new regional growth poles (e.g., Brazil, China, Turkey, Indonesia) illustrate how developing countries can use this FDI virtuous cycle in their strategy to becoming emerging markets. FDI inflows played a key role in access to technology, know-how, finance, and international markets, and in creating meaningful employment.

70. *Partnership countries showed in the 2000s how market reforms, after a time lag of two to three years, can raise the profile of an economy and bring it to the attention of investors, leading to FDI projects, new economic activities, and jobs.* While the global flows of FDI tripled in the few years preceding the 2008 global financial crisis, those going to the Partnership economies increased at an even higher rate in most cases, albeit from a very low level. Yet the FDI inflows to partnership countries also point to a set of political economy, policy, and regulatory issues that are holding them back from benefiting fully from globalization. Those issues are within the power of the authorities to address, and doing so could position these economies to take advantage of FDI for the economic and social development of their respective countries and of the whole region. The manufacturing and services sectors, where most jobs are generated, have not been able to attract their shares of FDI, compared to the petroleum and real estate sectors. The limited investments received in manufacturing and services have generated little local added value because of impediments to spillover effects on the host economy. Despite initiating reforms of their FDI regimes, all five Partnership countries are performing below world averages and below their potential in attracting FDI (Table 3). Mixed feelings toward FDI are rooted in economic policy paradigms predating the prominence of emergent markets and the rise of globalization, including in the form of global value chains and regional production networks—an ambivalence that has not yet been fully overcome.

**Table 3. Inward FDI Potential Index, 1990–2009**

	1990	1995	2000	2005	2006	2007	2008	2009	Average 05–09
Egypt	67	79	70	85	87	88	92	88	88
Jordan	53	59	67	63	62	66	72	71	67
Libya	52	47	44	40	36	34	34	63	41
Morocco	74	94	94	88	89	93	94	95	92
Tunisia	65	72	71	62	65	68	68	72	67

Source: UNCTAD 2011.

Note: The Inward FDI Potential Index indicates whether an economy is attracting FDI according to its potential. The index takes into consideration 12 economic and structural variables. A score of less than 100 means that the economy is performing below its potential in attracting FDI.

71. ***Looking forward, the political, social, legal stability in Partnership countries will be a key prerequisite to attract more foreign investors and persuade them to establish and operate their businesses.*** Equally important, foreign investors need markets and compelling business opportunities to invest in those markets. This would require Partnership countries to streamline their de jure restrictive investment regimes and adopt a timetable for phasing out restrictions on foreign equity participation in all economic sectors, except perhaps for a short and reasonable negative list. They would also need to streamline their de facto restrictions, mainly the limited licenses issued in various sectors and other administrative devices such as the practice of “pauses” in Egypt. Taking full advantage of their various international investment agreements and negotiating new investment agreements with the EU, the United States, and other Deauville partners would help further open their markets and eliminate the remaining market access restrictions to foreign investors, especially in critical economic sectors such as banking and insurance, electricity, and transport. Opening up to foreign investors would also require the completion of the privatization program so that fair competition and a level playing field are established in all economic sectors.

72. ***Once such a level playing field is created, Partnership countries should simplify and rationalize their investment policies and foreign investment regimes.*** In particular, they should streamline the set of incentives currently embodied in multiple investment regimes under different laws. One approach would be to study the impact of the reforms piloted in numerous special economic zones and related schemes with a view to extending the best features in the areas of tariffs, regulatory requirements, labor regulations, and corporate governance to the rest of the economy under a unified framework. A first simple and practical step to streamline procedures and ease the regulatory burden of foreign establishment would be to create or strengthen one-stop shops for foreign investors. Another critical consideration for foreign investors in their investment destination decisions is ease of access to production factors: industrial land, foreign exchange, and expatriate workers. In particular, foreign investors need better information on land (e.g., cadastres and land registries) and availability of land for business purposes, including the process of leasing land. Finally, the attractiveness of Partnership countries as FDI destinations will also depend on the exit options available to investors and their predictability. Partnership countries need to develop and implement comprehensive and modern bankruptcy laws, strengthen the coverage of expropriation laws in the national legal framework, including the principles of nondiscrimination and compensation, and establish transparent and credible investor-to-state dispute settlement mechanisms within a modern arbitration law.

73. ***Partnership countries should also take steps to attract FDI inflows with high potential for technological and employment spillover effects on the domestic economy.*** Facilitating access to finance, especially for new and potential entrepreneurs who lack working capital, is key for reaping the positive demonstration, competition, and linkage effects of FDI on domestic producers that can help them upgrade technologies and practices. This requires far-reaching reforms to improve financial access and stability in Partnership countries (World Bank 2011b). Expanding workers' training by firms could help upgrade the composition of exports toward more technologically advanced products. Given the high share of graduates who are unemployed, such an effort by firms—perhaps supported by active government policies—could yield positive results, both increasing exporters' productivity and reducing employment among skilled people. Strengthening trade and FDI support institutions, such as export promotion and investment agencies, to help private sector firms effectively discover and exploit international market opportunities is another key means to enter more sophisticated export markets and survive in the global economy. This often requires the effective presence of dedicated (public-private) representations in the targeted markets. Finally, by offering foreign investors access to a broader regional market, enhanced intra-Arab integration could reinforce the bargaining power of the host location and thereby influence the type of activities being outsourced as well as the relationships with upstream and downstream domestic producers.

74. ***The Deauville Partnership could be an opportunity for Deauville partners to help strengthen policies, rules, and institutions to support FDI in Partnership countries.*** In particular, as part of the DCFTAs and MENA TIP, the EU and the United States should launch negotiations on investment with a view to increasing legal protections for investors and providing a level playing field for all investors, including common standards of treatment and rules within an open, transparent, and predictable investment framework. Over the medium term, the objective would be to establish a single Euro-Mediterranean market for capital and to help Partnership countries achieve full approximation of their rules to best international practices, including mechanisms to settle disputes. Each of the Partnership countries would also benefit from a strategic review of its international investment agreements with a view to implementing existing bilateral investment treaties that are not yet in force and promoting insertion in global or regional value chains, especially within the context of the Agadir agreement. Based on their own liberalization experience, Deauville partners could help Partnership countries develop national programs to open up and privatize various sectors exhibiting monopolistic or quasi-monopolistic behavior, such as telecommunications, insurance, electricity production, postal services, and railway and air transport. Deauville partners could further develop their training and capacity-building programs for government staff in Partnership countries, at the national and local levels, to help improve the administration of laws and regulations relevant to FDI, including expatriate work permits, commercial license renewal, infrastructure services, and customs. Deauville partners could also scale up their technical assistance support to facilitate access to information for potential foreign investors, including systems whereby new laws and regulations of interest to foreign investors are translated into English and other languages upon their promulgation and are made available on government websites.

## FDI regime: Key selected recommendations

### Short-term:

- **Adopt a timetable in Partnership countries for phasing out restrictions on foreign equity participation in all sectors, except for a short list of sectors with high degree of monopoly power, respecting the principle of national treatment.**
- Review the impact of the reforms piloted in the special economic or offshore zones in Partnership countries for the purpose of considering extending them to the rest of the economy. Consolidate the legal framework for investment in Partnership countries under one open, transparent, and predictable investment code.
- Develop a national program to open up to competition and potentially privatize remaining sectors exhibiting monopolistic or quasi-monopolistic behavior in Partnership countries, such as telecommunications, insurance, electricity production, postal services, and air transport.
- Improve access to information on land (e.g., cadastres and land registries) and the availability of land for business purposes, including the process of leasing land, and take steps to substantially reduce transaction time.

### Medium-term:

- **Negotiate between Partnership countries and Deauville partners investment provisions in future deep and high-quality trade agreements to increase the legal protection of investors and provide a level playing field for investors, including common standards of treatment and rules.**
- Review and develop strategic approaches in partnership countries to international investment agreements (IIAs) to promote insertion in global or regional value chains and implement existing bilateral investment treaties that are not yet in force.
- Support the establishment of effective investor-to-state dispute settlement mechanisms through the arbitration provided for in bilateral investment treaties, when relevant, or through the establishment of stand-alone arbitration law as a positive sign to investors.

## BUSINESS CLIMATE

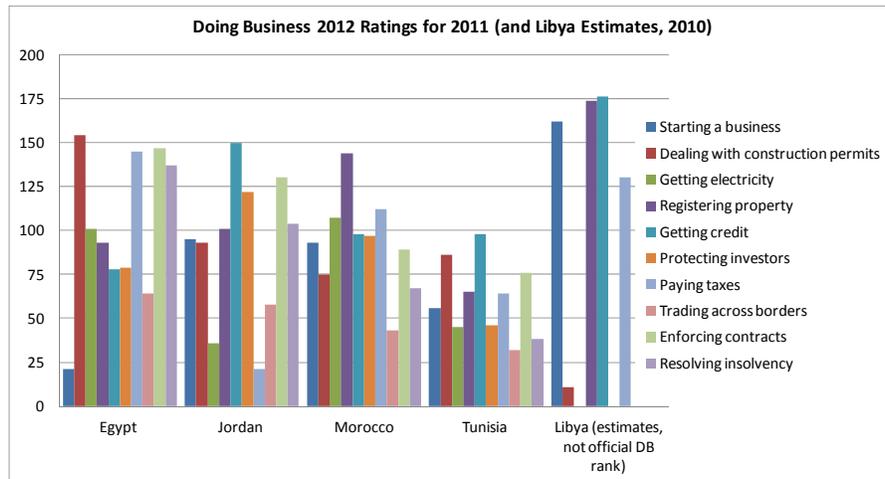
75. *Trade and FDI reforms cannot yield their full benefit in terms of economic development without complementary domestic investment climate reforms. To encourage FDI, a sound business climate is an essential complement to the foreign investment regime.* One of the central challenges in reaping greater benefits from globalization lies in improving the domestic business environment: providing sound regulation of industry that promotes competition, overcoming bureaucratic delay and inefficiency, fighting corruption, and improving the quality of infrastructure. Evidence shows that the impact of trade on living standards is much higher in well-regulated economies than in most heavily regulated economies. Interestingly, relaxing barriers to business entry as a complementary policy to trade seems more important as a means to improve living standards than relaxing labor restrictions. Furthermore, while the investment climate is clearly important for large firms in the formal sector, it is just as important—if not more so—for SMEs and the informal sector, and also for agricultural productivity and the generation of off-farm employment. Productive private employment is the central pathway out of poverty for workers and their families, so a vibrant and inclusive investment climate is critical to achieving poverty alleviation and social justice. Investment climate refers to the policy and institutional underpinnings of markets, including a broad range of policies and agencies. It also may include services such as infrastructure (or the regulatory framework for its provision).

76. *As already noted, the past decade has demonstrated that trade liberalization without reforms to improve the functioning of domestic markets and services will not generate substantial employment. Companion policies are needed to strengthen the investment climate and relax behind-the-border constraints, especially in trade-related services.* These constraints increase the cost of doing business and limit the attractiveness of MENA as a place to invest (Dasgupta et al. 2002). As observed in Egypt and Tunisia, the coalescence of political, economic, and military interests can lead to the accumulation of market power and its abuse. Public policies too may restrain competition, including through various barriers to entry. These include the above-mentioned NTMs; anti-dumping laws; investment policies such as exclusionary lists, ownership restrictions, or licensing restrictions; and restrictive sectoral regulations. Indeed, inappropriate regulation, whether de jure or de facto, can completely suppress the benefits of trade liberalization. Markets may also be segmented by transportation and transaction costs, by public policies, or by a number of anti-competitive business practices, each of which can protect incumbent firms from competition (and inhibit new foreign investment) while limiting efficiency and consumer welfare gains from liberalization (Khemani 1997). Without an integrated approach to competition—one that embraces trade, regulation, and investment policies—the objectives of resource mobility, productivity gains, and improved consumer welfare may remain unrealized.

77. *Partnership countries (and the MENA region more broadly) tend to underperform in key areas that foreign investors consider in their decisions on location of greenfield investments: market access, a stable political environment, ease of doing business, and the reliability and quality of infrastructure and utilities. A first key issue is market access and market contestability.* Barriers to firm entry and to sound competition may be due to government policies or to the discriminatory way in which rules are implemented and enforced. This is both an important source of privilege and a key impediment to the emergence of a dynamic private sector in Partnership countries. Reforms have been made, but their quality is a problem, and there is a widespread belief that the business environment as it appears “on the books” does not apply equally to all. For instance, competition and commercial laws have been promulgated and competition agencies established in all the Partnership countries except Libya, but these have had little effect in terms of effective market contestability and competition on the ground. Most commercial codes suffer from structural flaws and numerous gaps: lack of adaptation to the latest banking and financing practices, cumbersome company registration, ambiguous corporate governance rules, gaps in the collateral framework, and absence of implementing decrees.

78. *A second key issue is the ease of doing business.* Partnership countries have mixed performance on a number of key indicators in the World Bank’s 2012 Doing Business index (Figure 5). Even Morocco, which ranked among the top reformers in this regard, faces continuing challenges with respect to coordination of reforms, clarification and simplification of business law, reduction in delays in registering property, relatively high taxes and time-consuming compliance, costly access to electricity, SME access to finance and land, and worker skills (World Bank 2011a). In general, regulations impose significant barriers or burdens on firms, especially SMEs, which constitute the bulk of enterprises in every Partnership country.

Figure 5. Doing Business Rankings



Source: Doing Business website, [www.doingbusiness.org](http://www.doingbusiness.org).

79. ***But the de jure legal business environment only partially explains the Partnership countries' lackluster performance in higher-value-added activities.*** Surveys of firms in Morocco and Jordan reveal large variations in government officials' implementation of legal regulations across firms in both countries, relative to most other emerging economies. Uncertainty about policy implementation discourages new entrants and imposes substantial costs on incumbent firms, which have to undertake costly mitigating actions.

80. ***Looking forward, Partnership countries face a wide range of policy challenges for which there are no simple answers. Whatever their country-specific priorities, Partnership countries will need to develop a three-pronged strategy: effectively foster competition and limit opportunities for rent seeking, build strong market institutions, and mobilize key stakeholders and broad sectors of the population to support a long-term strategy.*** With the proper regulatory environment, governments can encourage entry of foreign and domestic investors alike in all sectors of the economy by removing formal and informal barriers to competition. In conjunction with the governance agenda discussed below, substantial decision-making power over economic outcomes could be delegated to strong, rule-bound market institutions to reduce discretion and opacity, improve the quality of services provided to firms—hence reducing transaction costs—and increase transparency and accountability of all public bodies that interact with the private sector and regulate markets. Strong market institutions would also ensure equity in market governance, thereby reducing de jure and de facto barriers to competition.

81. ***A new form of partnership is also needed in each country between government and the main stakeholders to underpin stronger reform alliances and broader participation in designing, implementing, and evaluating policies.*** Through an institutionalized, transparent, and inclusive process, business associations and the private sector more broadly should be engaged in identification of policy issues and in the design, implementation, monitoring, and evaluation of reforms. In terms of inclusiveness and coordination of policy making in the competitiveness area, the Moroccan National Committee on Investment Climate (CNEA) provides a good model for the design and monitoring of investment climate reforms. Deauville partners could become trusted mentors of investment climate

reforms in Partnership countries. To oversee and monitor reforms, governments need to find ways to coordinate the activities of diverse government bodies and supply political backing and resources. In the case of legal reforms, the common heritage of Partnership countries opens opportunities for common approaches and broader Arab world initiatives. Donor countries can support many of the required initiatives financially and technically, as well as by sharing knowledge of global experience and technical support.

#### **Business climate: Key selected recommendations**

Short-term:

- **Modernize commercial codes in Partnership countries, adapt them to the latest banking and finance practices, and simplify company registration.**
- Establish and/or strengthen public-private consultation mechanisms in Partnership countries to design, implement, evaluate, and monitor public policies and reforms

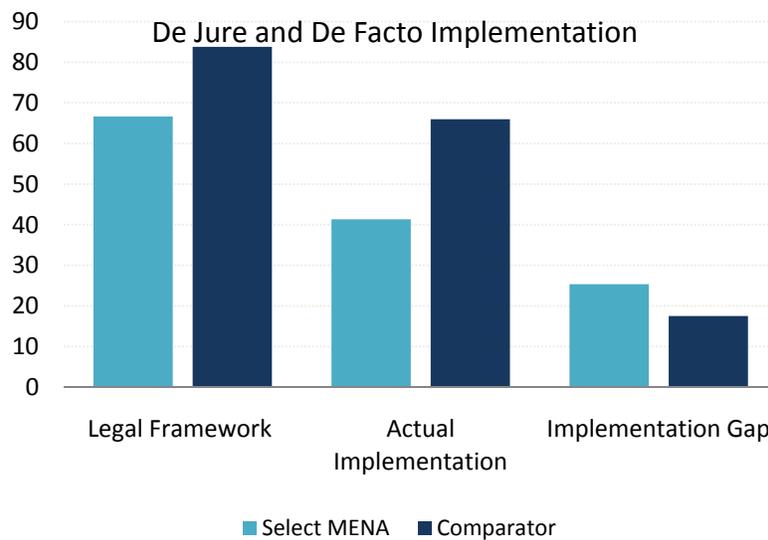
Medium-term:

- **Invest in capable, rule-bound market institutions to underpin the proper functioning of markets in Partnership countries, including regulatory authorities and public service providers. Such institutions should operate under the principles of transparency and accountability for results.**
- Address existing policy gaps in Partnership countries' ease of Doing Business and improve market access and contestability by removing barriers to entry, exit, and competition.

## **ECONOMIC GOVERNANCE**

82. *Stepping back from the details of policies and regulations, it becomes clear that weak economic governance more broadly has undermined the effectiveness of sometime well-inspired economic and trade policies.* For this reason in part, important reform efforts over the last decade did not yield the expected economic outcomes and job opportunities. Economic reform cannot fully deliver without effective, transparent, and credible rules. Shortcomings in the overall governance framework, characterized by pervasive corruption and a lack of voice and accountability, exposed key economic institutions in Partnership countries to capture and undermined their quality and credibility. This has reduced the effectiveness and fairness of policies, distorted competition, and negatively affected growth and employment in the formal private sector. The lack of accountability and transparency and the large gap between de jure and de facto rules have further increased the potential for discretion, favoritism, and corruption. Although the problem is hard to quantify, enterprise surveys and international indicators, such as those by Global Integrity or Transparency International, confirm the seriousness of the issues, particularly in comparison with countries such as Chile, Brazil, Mexico, Poland, and Turkey (Figure 6). These uncertainties and risks have contributed to the relatively low level of domestic and greenfield foreign investment in MENA in the last decade, compared to other regions.

**Figure 6. Ratings for MENA countries and comparator countries on Global Integrity’s “Rule of Law” indicator**



Source: Global Integrity website, [globalintegrity.org](http://globalintegrity.org).

Note: “Select MENA” represents the combined average of Egypt, Jordan, and Morocco. “Comparator” represents the combined average of Chile, Brazil, Mexico, Hungary, Poland, and Turkey.

83. ***Modern governance principles of transparency, accountability, and participation are key determinants for more productive economies.*** This is shown by economic research (Acemoglu and Robinson 2010) as well as by the welfare gains of successful transition countries in East Asia and Eastern Europe, which have put in place effective safeguards to ensure greater government accountability. The current transitions offer a unique opportunity to address deep-seated economic governance challenges. Most Partnership countries have engaged in ambitious reforms to improve their governance framework through greater checks and balances and rule-based institutions. But irregular and exclusive consultations between the public and private sectors have left most of the business community out of the policy process. Increased transparency and public participation are thus important ways to support this transition and help restore trust. Decision-making power has long been concentrated at very high levels, often beyond formal government structures. This is why Tunisia and Morocco are modernizing their governance structures by empowering accountable governments, parliaments, and judiciaries and focusing their reform agenda on improving voice, accountability, and transparency. The main challenge now is the consolidation and implementation of comprehensive legal, regulatory, and institutional changes. These reforms should lead to a more consistent implementation of rules and regulations and to an effective fight against corruption, signaling a break with the past.

84. ***State capture, discretion, and arbitrariness have undermined the effectiveness of economic policies and institutions.*** The uneven implementation of economic policies has reinforced inequality and the perception of injustice. Economic liberalization and integration policies have increasingly been seen as mainly benefiting the ruling and business elite, while adjustment costs are borne by the population. Rent seeking and state capture have flourished in this environment of privileges and patronage. This has led to the emergence of small groups dominating the market, with low productivity and no incentive to

innovate, stifling economic and job opportunities. While some sectors have been increasingly exposed to foreign competition with tariff dismantling, such privileged groups have captured service sectors, which are more heavily regulated and less contestable. As shown in World Bank reports,<sup>7</sup> this has weighed negatively on the development of a knowledge-based and competitive economy. It is important to correct these imbalances and the underlying governance deficiencies in order to restore the confidence of economic operators and build popular support for the economic integration agenda. Strengthening the mandate and independence of key economic institutions, such as competition and tax authorities, and launching a transparent regulatory review to reduce discretion and anti-competitive behaviors can build confidence and increase the benefits of deeper economic liberalization and integration.

85. ***Past anti-corruption strategies have had limited impact, as evidenced by the region's poor ranking in Transparency International's Corruption Perceptions Index as well as enterprise surveys conducted by the World Bank and the World Economic Forum.*** These strategies were essentially based on high-level international conventions, such as the United Nations Convention against Corruption (UNCAC), and lacked the necessary enforcement mechanisms. The considerable gap between anti-corruption legal frameworks and their actual implementation is evidenced by “very weak” ratings on Global Integrity’s governance indicators. Morocco and Tunisia have taken initial steps to strengthen their legal and institutional anti-corruption frameworks.

86. ***Specific reforms in the areas of conflict of interest, asset disclosure, and complaint mechanisms would do much to strengthen accountability and transparency.*** A key priority is to strengthen the legal framework regarding conflicts of interest. In principle, political leaders should divest from existing economic ventures that could create conflicts between their public responsibilities and their private interests. At the very least, they should publicly disclose information on their participation in such ventures and refrain from decision making in related areas. In addition, the current income and assets disclosure regulations for public officials should be revised to make them more comprehensive and more available to the public. This would facilitate public scrutiny and build trust.

87. ***A truly independent and effective judiciary would strengthen the system of checks and balances and ensure the rule of law.*** Throughout the MENA region, inconsistent and unequal enforcement of laws has eroded public trust in government and has negatively affected business confidence and foreign investment. Global Integrity ratings for the strength of the rule of law in MENA highlight enforcement of judicial decisions and judicial independence as two areas of particular weakness. Reform efforts should thus focus on improving the independence, accountability, and effectiveness of the judiciary. Although issues and priorities vary across countries, recent assessments suggest the need to address both the de jure and the de facto independence of judiciaries.

88. ***Greater government transparency and access to public information are important levers for improving trust in and effectiveness of the countries' economic policies.*** Partnership countries have much scope for progress in improving access to information. According to Global Integrity, the MENA region is the weakest on indicators measuring civil society, public information, and media, at 32 percent below the global average. At present, only Jordan has a specialized freedom of information law, and it

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<sup>7</sup> For example, see the Tunisia Development Policy Review (World Bank 2010b) and MENA flagship report *From Privilege to Competition* (World Bank 2009a).

needs to be strengthened to meet international standards. Tunisia has recently adopted such a law and needs to adopt the necessary implementation rules and regulations. Morocco's new constitution provides the right to access public information. Greater transparency reduces discretion and corruption, and contributes to economic growth. Recent studies in the EU estimate the direct and dynamic gains from the use and reuse of public sector information at up to 1.7 percent of GDP for the EU27 in 2008 (Vickery 2011). Partnership countries could usefully reinforce the monitoring and evaluation of public and elected officials to make their decisions and actions subject to increased public scrutiny.

89. *Deauville partners should support governments across the region in their efforts to restore trust in policies and economic institutions, based on greater transparency and accountability.* The proposed comprehensive free trade agreements with the partner countries offer a good basis for the necessary economic governance reforms. Beyond the built-in regulatory and institutional convergence, these agreements would signal the commitment of Partnership countries to promote a level playing field and the rule of law. Such a strengthening of governance structures, institutions, and policies would in turn help restore the trust and confidence that domestic and foreign investors need to invest and create jobs. The Open Government Partnership, launched last September, provides a platform for the exchange of experiences among countries committed to the principles of open and transparent government. Technical and financial support from Deauville partners will be required to support the implementation of this complex reform agenda.

#### **Economic governance: Key selected recommendations**

##### Short-term:

- **Adopt a policy on transparency and free access to information and ensure that it is effectively implemented through clear and binding legislation, a strong institutional enforcement mechanism, and credible monitoring and evaluation and complaints systems.** Conduct communication and training campaigns to inform the public and civil servants of their new rights and obligations.
- Strengthen the independence and accountability of those economic institutions and regulators in Partnership countries whose credibility and effectiveness may have been undermined by capture and arbitrary use of discretion, such as the competition and tax authorities, customs, and economic and import control bodies.
- Adopt an effective anti-corruption institutional framework and implementation mechanism, based on a strong and independent anti-corruption body and on a credible and effective anti-corruption chain involving dedicated and specialized units in the police and the judiciary.

##### Medium-term:

- **Strengthen the independence, accountability, and effectiveness of the judiciary, especially by fully separating the high judicial council from the ministry of justice, by insulating administrative and human resource management for judges from undue interference, and by establishing robust performance monitoring and evaluation schemes, underpinned by automated case management systems.**
- Improve the accountability framework in Partnership countries by empowering accountability institutions with the necessary mandate and capacity to fully exercise their new role of checks and balances, by enhancing their own accountability by subjecting their actions to public scrutiny, and by strengthening the regulatory framework on conflicts of interest and public disclosure of assets for both senior officials and parliamentarians.

## KNOWLEDGE ECONOMY

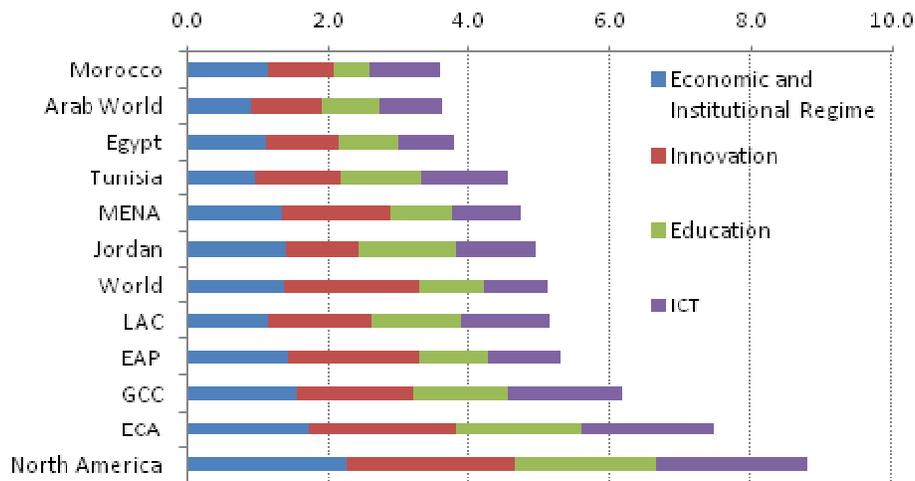
90. ***Development strategies all over the world are increasingly based on knowledge and innovation.*** Partnership countries are also engaged in revisiting their growth and development strategies with the objective of reducing unemployment, especially for educated youth. In this context, there is a renewed interest in moving to knowledge-based, productivity-driven growth models.

91. ***Succeeding in this new strategy requires decisive actions.*** A knowledge economy (KE) is one that utilizes knowledge as the key engine of economic growth. It is an economy where knowledge is acquired, created, disseminated, and used effectively to enhance economic development. Specifically, the knowledge economy requires:

- ***A regime of economic incentives and institutions*** that tap global knowledge (trade integration), efficiently allocate resources (well-functioning labor and credit markets), and stimulate creativity within a sound intellectual property regime (WIPO 2011).
- ***Educated and skilled workers*** who can continuously upgrade and adapt their skills to efficiently absorb, create, and use knowledge.
- ***An effective innovation system*** of firms, research centers, universities, consultants, and other organizations that can keep up with the knowledge revolution, tap into the growing stock of global knowledge, and assimilate and adapt it to local needs.
- ***A modern and adequate information infrastructure*** that can facilitate the effective communication, dissemination, and processing of information and knowledge.

92. ***On all these fronts, with a new governance framework in place and the support of Deauville partners, Partnership countries could make great strides*** (Figure 7). To take just one example, while Partnership countries have gone a long way toward catching up with the rest of the world in mobile telecommunications, much remains to be done to step up broadband capacity and to spread information and communications technology (ICT) usage to improve productivity and enlarge the exports base. In 2009, the Internet bandwidth per capita was 18 to 20 times larger in Bulgaria than in Tunisia, Morocco, and Jordan. The price per megabit in Bulgaria was three times lower than in Morocco, five times lower than in Tunisia, and 45 times lower than in Jordan.

**Figure 7. Knowledge Economy Index 2011 and its components**



Source: World Bank Institute, Knowledge Assessment Methodology; authors' calculations.  
 Note: "Arab World" excludes countries without data.

93. ***Going forward, Partnership countries need to step up their efforts to create the conditions for a KE takeoff.*** To this end, Partnership countries need to act on the four pillars of a KE:

- ***First, there is a need to further trade openness and harness more technological spillovers from existing and future FDI*** (Hoekman and Javorcik 2006). Ireland's National Linkage Program has made that country one of the most successful in terms of technology transfer and vertical integration. This could be replicated in the MENA region by launching similar programs or revamping existing initiatives such as Egypt's National Suppliers Development Program. Promoting innovation policies would also require the strengthening of intellectual property rights.
- ***Second, Partnership countries should consider a major overhaul of their education systems, including vocational training, to align them with twenty-first-century curriculum and learning practices.*** Although issues related to education reforms go beyond the scope of this report, the quality of human capital remains the single most important element driving economic progress in the long run.
- ***Third, Partnership countries would benefit from developing comprehensive innovation strategies with efficient coordination and monitoring and evaluation mechanisms.*** Partnership countries' experience in this area is nascent and needs to expand in scope and funding. Deauville partners could provide support for setting up innovation funds.
- ***Fourth, Partnership countries would benefit from further developing ICT infrastructure and universal access to competitive services.*** This would involve, inter alia, liberalizing long-distance international calls (as in Egypt) and broadband services; expanding online services by implementing e-government strategies, especially those geared toward businesses (such as e-regulation, online registration, e-taxation, customs and payments); setting up a conducive

regulatory framework for e-commerce; and supporting the growth of information technology industries, notably offshoring, which has a huge potential in most of the Partnership countries.

94. ***The Deauville Partnership is an opportunity to develop long-term cooperation in sharing knowledge, innovation, and know-how.*** A knowledge economy cannot emerge overnight, but requires sustained effort. Deauville partners could offer technical assistance and share their experiences in designing and implementing their own KE strategies. They could increase their support to the four pillars of a modern KE discussed above, namely support to SMEs, to take advantage of increased vertical integration and FDI spillovers; support to education reforms and programs; support to innovation strategies; and support to further ICT development.

95. ***Regional cooperation could also be part of the answer.*** Within the Arab world, there is scope for developing regional education programs building on a common language and shared culture by encouraging Arab students' mobility, setting up regional research programs, and promoting open information societies. At the Euro-Mediterranean level, the EU could support further participation of the Partnership countries in the European Research Area, which aims to create a single space for research in Europe and has already funded many research and development (R&D) projects in Mediterranean countries through its ERA-WIDE window. The EU and the other Deauville partners could facilitate technology transfer and better networking of institutions dedicated to services for business innovators and augment the resources allocated to ERASMUS and TEMPUS programs for Partnership countries. Finally, co-development policies of GCC and G8 countries could tap the diaspora of Partnership countries for the design and implementation of KE strategies.

#### **Knowledge economy: Key selected recommendations**

##### Short-term:

- **Liberalize fully the telecommunications sector in Partnership countries, step up the competition, increase broadband capacity, and upgrade the mobile technology by moving toward 4G licensing and using it in some cases to obtain full telecommunications licenses for existing operators to foster competition.**
- Cooperate on intellectual property rights with G8 countries in support of national innovation policies, possibly in the context of future deep and high-quality trade agreements.

##### Medium-term:

- Develop an innovation-driven development strategy that steps up investment and trade and encourages their technological spillovers in Partnership countries with effective and well-coordinated institutions, medium-term budgeting, and monitoring and evaluation frameworks. Instruments can include the European Innovation Scoreboard.
- Reform the public R&D system to better align it with national priorities and increase substantially the public resources allocated to innovation in Partnership countries (e.g., seed capital, matching grants). At the same time, grant incentives to the private sector to step in, and reinforce the protection of property rights to attract more foreign-financed research and patenting. Support from Deauville partners can include the establishment of innovation funds.
- Expand innovative sites (special economic zones, technology parks, knowledge clusters, and knowledge cities) in Partnership countries based on comparative advantages and private sector-led approaches that group together businesses, education and training institutions, and R&D centers.

## 5. FACILITATING TRADE AND ACCESS TO TRADE FINANCE AND REMITTANCES

96. *Tackling costs associated with inefficient trade facilitation and logistics and weak access to trade finance and remittances is central to further integration of Partnership countries, both regionally and globally.* The costs of “connectivity” are often fixed, and as a result they disproportionately affect small firms, farmers, and the poor, severely limiting their participation in trade and investment. Reducing the costs associated with moving goods along international supply chains, whether these costs are measured in terms of time, money, or reliability, is a core element of a trade and FDI agenda. Such costs are also partly determined by access to and pricing of trade finance and associated export credit insurance products. This factor has become more important for Partnership countries’ exporters, especially small and medium enterprises, since the recent crisis, as higher financing costs are expected to prevail in the medium term. There are three Deauville Partnership priorities in this area:

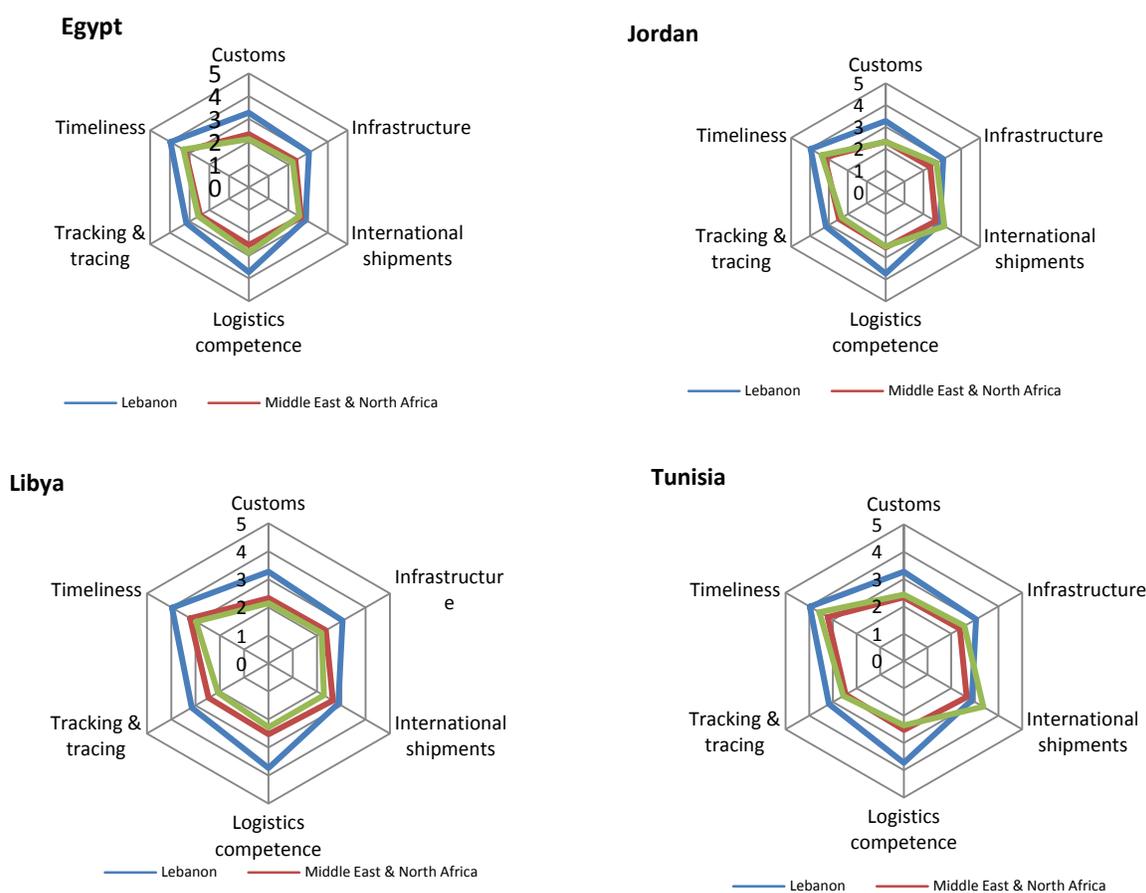
- Modernize *trade facilitation* services by enhancing the performance of trade corridors, whether air, sea, or land; improving markets for logistics services; increasing the efficiency of border management, including customs; and facilitating the cross-border movement of service suppliers.
- Improve access to affordable *trade finance* and related insurance and guarantee products for SMEs, including Islamic finance; build the technical capacity of both SMEs and financial institutions in the management of trade finance at all transaction stages; and develop new inter-firm finance products, such as factoring.
- Harness the remittances, technology and skills transfer, and investment of workers abroad by strengthening engagement with the *diasporas*, using government institutions such as embassies and consulates; mobilize diaspora savings through the issuance of targeted financial instruments, such as diaspora bonds; and establish more dedicated diaspora programs to promote development in countries of origin.

### TRADE FACILITATION

97. *Trade facilitation and services logistics are important factors for competitiveness.* To be successful, an export-oriented trade and investment policy has to be in harmony with and facilitated by modern trade logistics. This is an additional condition for the development of an intra-regional trade and FDI network, leading to emergence of production networks among Partnership countries. No cross-border value-added chain can develop, thrive, and foster a regional competitive advantage unless there is a high degree of flexibility in movement of goods and services. The trade facilitation and logistics agenda is broad and includes addressing the links between investments in hard infrastructure and the policy actions that are needed to facilitate trade flows and improve the efficiency of supply chains linking domestic producers and buyers to their international partners, whether in the same regions or in distant markets.

98. **Overall, Partnership countries are shouldering higher trade costs than their main competitors on third markets; they also incur skyrocketing costs when trading among themselves.** Data on the performance of logistics services and on the internal costs associated with shipping goods, both from factory gate to port and from port to retail outlets, suggest that traders in Partnership countries confront significant hurdles. According to the Logistic Performance Index (World Bank 2010a), the MENA region performs better than the Sub-Saharan Africa and South Asia regions but lags slightly behind East Asia and Pacific, Europe and Central Asia, and Latin America and the Caribbean. In Partnership countries, infrastructure quality, efficiency of border clearance, and the quality and competence of service providers, are areas that need further attention (Figure 8). It has been estimated that a 5 percentage point reduction in trade costs between the Maghreb and Western Europe would potentially increase trade in industrial goods between the two regions by 22 percent.

**Figure 8. LPI Individual scores vs MENA and best performer in MENA: Lebanon**



Source: World Bank 2010a.

99. ***Bottlenecks in trade facilitation and services logistics relate mainly to soft infrastructure constraints, such as in customs and other border agencies, trade and transport facilitation frameworks, and trade logistics services providers.*** Infrastructure appears to be a less significant issue in the region than constraints associated with trade processes and low quality of some logistics services.

100. ***Reform of customs administrations, policies, and practices continues to be a high priority for Partnership countries.*** Customs is the state administration whose functions lie closest to the heart of international trade. Through its relations with economic operators and users, its tariff and nontariff measures, its procedures, and also its integrity, the customs regime is one of the factors influencing the decisions of foreign investors and determining the success of a free trade area. The Deauville Partnership initiative is therefore an opportunity for Partnership countries to obtain international support for efforts to tackle the structural constraints to greater openness with concrete action focusing on customs. Most customs control structures in Partnership countries need modernization. For instance, customs officials are often not trained in techniques for controlling violations such as counterfeiting or infringements of rules of origin, and they do not necessarily have the resources to travel. Insufficiently developed computerization hinders the creation of up-to-date databases that cover the entire territory and can be used for data mining and effective targeting. Access to useful private and public databases (on port container parks, airplane and vessel movements, and manifests) through the Internet is still limited. Deauville partners could also support bilateral and regional customs cooperation.

101. ***Partnership countries need to pay more attention to modernizing other control agencies at the border, including health, agriculture, quarantine, police, immigration, standards, and so on.*** Customs is not the only agency involved in border management. In Partnership countries, one-third to nearly one-half of goods are subject to physical inspection, and customs reforms alone will not address the performance concerns. Improving border management entails a coordinated approach involving all agencies involved in the clearance process. Partnership countries are already working on making these processes part of a single window and better integrating the various controls to avoid redundant inspections. This modernization agenda is also tied to the reduction of the nontariff measures discussed above and would benefit from stronger support from Deauville partners. Broader automation in the form of port community systems or automated single windows typically helps coordination and speeds the communication of documentation and information about the clearance process. Information sharing between trading communities (e.g., freight forwarders) and trade-related agencies, whether in the same country or between countries, is also important.

102. ***Partnership countries have much to gain from improving subregional trade corridors and regional trade facilitation frameworks.*** In most trade corridors, existing or projected investment in infrastructure will not deliver benefits without effective transit systems. The efficient movement of goods and vehicles across borders and overland over long distances requires a seamless transit system at the regional level, or at the very least between neighboring countries. While various formal regional and bilateral agreements are in place, implementation is often jeopardized by poor cross-country cooperation. Furthermore, there is little communication between technical agencies (particularly customs and transportation) aimed at creating a common trade and transport facilitation framework. For instance, there is no agreement on a transit regime to facilitate movement from origin to destination along several borders, although several countries are already parties to the TIR (International Road

Transport) convention. Partnership countries could benefit from coordinating policies and regulatory changes as well as transport and border crossing infrastructure investments in key transport corridors.

103. ***Deauville partners could provide targeted assistance*** on key issues, especially the lack of coordination in implementation of national projects and policies; the failure to integrate cross-border facilities and procedures between countries; the uneven application of rules of origin within PAFTA; the low quality of trucking fleets, low level of use of TIR, and long delays at borders with third countries; the inadequate transport infrastructure and lack of properly equipped border crossing facilities; and the absence of subregional trade hubs and subregional economic or corridor management arrangements.

104. ***Finally, there is a need to upgrade the competence and quality of service providers in air and maritime transport and freight forwarding.*** Partnership countries are still struggling with the modernization of logistics services. Regulations often reduce the efficiency of trucking markets, while prevailing business and operating practices may interfere with the integration of domestic supply chains into the networks of global logistics providers. Rationalizing and simplifying regulations and increasing the competitiveness of a range of service providers can make trade faster and more cost-effective, thus helping attract FDI to export industries and infrastructure, as well as to logistics and ancillary services. Trucking reform is a major problem in Morocco, Tunisia, and Egypt. Informality and relatively small distances prevent the emergence of a network of high-quality medium-size transport operators, which has implications not only for logistics but also for road safety and urban management. Intermediary professions (e.g., brokers, agents) also tend to be very fragmented, with insufficient quality control, while nationality requirements for brokers (except in Morocco) favor a small number of well-connected domestic operators. Yet reforms are possible. In 2007 Jordan implemented an innovative loading-by-appointment system at the port of Aqaba, which forced truckers to operate in formal companies. This transformed the market structure of trucking operations in the corridor serving Amman and Iraq.

105. ***In the area of trade facilitation and logistics, the Gulf countries are ideally placed to assist Partnership countries and transfer their expertise and know-how in the area of infrastructure and services logistics.*** The GCC member countries stand out in terms of their performance in trade facilitation, infrastructure, and logistics, which comes close to that of other high-income economies. The United Arab Emirates has developed a world-class logistics hub in Dubai. Furthermore, the GCC is the most advanced case of subregional integration in the broader MENA region. For the GCC countries, regional security threats, the proliferation of regional trade agreements worldwide, and the rising forces of globalization have contributed to the momentum toward integration in recent years.

### Trade facilitation: Key selected recommendations

#### Short-term:

- **Pursue the modernization of customs in Partnership countries, including through computerization and by training staff in techniques for efficiently controlling violations.**
- Upgrade the quality of logistics service providers in air and maritime transport and freight forwarding in Partnership countries, including by rationalizing and simplifying regulations and increasing competition in a range of service providers (e.g., truckers, brokers, agents).

#### Medium-term:

- Automate the operations of all other border agencies in Partnership countries through single windows to better coordinate and accelerate communication among agencies.
- Improve subregional trade corridors and regional trade facilitation frameworks in Partnership countries, including agreement on transit regimes to facilitate movements from origin to destination along several borders (building on the International Road Transport convention), and coordinate policies and regulatory changes as well as transport and border crossing infrastructure in key transport corridors.

## TRADE FINANCE

106. ***With more than 90 percent of international trade transactions involving some kind of credit, insurance, or guarantee, trade finance plays a critical role in facilitating the international trading system.*** The global trade finance market, worth about US\$16 trillion before the 2008 crisis, provides capital to firms engaged in international trade transactions, reduces the risks related to these transactions, and provides payment and insurance mechanisms. With the emergence of regional and global value chains, trade finance activities have also evolved to go beyond providing traditional bank-intermediated financial solutions for import and export operations, such as letters of credit, to develop more advanced and sophisticated inter-firm modes of financing. Trade finance, whether through banks or inter-firm credits, is the lifeblood of exporters and importers, especially SMEs. Any disruption to the financial sector's ability to provide working capital or pre-shipment export finance, issue or endorse letters of credit, or deliver export credit insurance could create a gap in complex, outward-processing assembly operations and lead to a contraction in trade, output, and employment. In times of economic crisis and political uncertainty, trade finance is an especially rare and expensive commodity (Chauffour and Malouche 2011). Banks are increasingly cautious with real sector customers and counterparty banks, and pricing margins are often increased. These stricter risk management practices are coming in response to higher risks. In the context of the Arab Spring, for instance, an example is the recent decision by the Indian credit insurance to stop covering exports to Tunisia, Egypt, and Yemen.

107. ***Given the importance of trade finance for export development, especially of SMEs and new exporters, and the importance of SMEs in stimulating growth and employment, trade finance should be part of Deauville Partnership efforts to promote trade and FDI.*** It is an essential element of any export-led growth strategy. Although Partnership countries perform reasonably well when it comes to the provision of competitive trade finance facilities to large and established firms, access to affordable trade finance—and for that matter, access to finance in general—remains a key bottleneck for SMEs.

108. ***In this period of heightened economic and political uncertainty, Deauville partners, especially the international and regional financial institutions, could scale up and coordinate their trade finance liquidity programs as well as their trade finance insurance and guarantee programs.*** Example include the International Finance Corporation's Global Trade Finance Program and Global Trade Liquidity Program, the African Development Bank's Trade Finance Initiative, and the Islamic Development Bank Group's shariah-compliant trade financing (Murabaha financing). Once the European Bank for Reconstruction and Development receives its new operational mandate to operate in the MENA region, its trade facilitation program could also be extended to Partnership countries.

109. ***Deauville partners could also help strengthen the Partnership countries' export credit agencies.*** Currently, the volume of business insured by the four local export credit agencies is marginal. Strengthening the status and operations of these agencies could enhance the participation of local private banks in financing trade activities and SMEs. Partnership countries could benefit from the Organisation of Islamic Cooperation's (OIC) Executive Program for Enhancing Intra-OIC Trade to promote the development of credit and political risk insurance among OIC member countries. And the World Bank's Multilateral Investment Guarantee Agency could expand its political risk guarantee facilities (MIGA 2011).

110. ***In raising trade finance, SMEs in Partnership countries could also benefit from coordinated support in three main areas: producing bankable proposals supported by sound financial figures and business plans, receiving adequate support from national institutions and sector associations, and bridging the knowledge gap that impedes credit assessment by lending institutions.*** Initiatives are under way in Partnership countries to build the capacity of both beneficiaries and financial institutions in the management of trade finance at all transaction stages. But structural issues such as skill mismatches, information asymmetries (e.g., absence of audited financial statements or credit histories), and adverse selection still pose great challenges to the provision of efficient and competitive trade finance facilities to SMEs. In the current uncertain context, development of hedging strategies is also necessary, but there is a general lack of capacity for this. Neither the financial industry nor the local exchanges provide appropriately adapted hedging instruments. Finally, the regulatory environment governing trade finance could be strengthened with the modernization of laws dealing with bankruptcy, commercial disputes, and other business matters. This and other regulatory improvements could be addressed as part of the regulatory convergence negotiated in free trade agreements (e.g., DCFTAs).

111. ***In the medium term, SMEs in Partnership countries would benefit from broader access to all kinds of financing instruments, including Islamic finance.*** Addressing the problem of restricted access to finance requires implementation of a comprehensive financial development agenda. This should include improvements in financial infrastructure (credit information and credit rights); measures to enhance banking competition and address the historical connections between large banks and large industrial groups; and measures to diversify the financial system through the development of nonbanking institutions, instruments, and markets. Deauville partners could coordinate their support for this ambitious agenda. Partnership countries may also want to consider expanding Islamic finance under a suitable regulatory environment. As regards inter-firm finance, Partnership countries should explore means to develop both factoring and reverse factoring to provide alternative financing sources for SMEs in their attempts to integrate global value chains.

112. *In addition to trade finance, SMEs in Partnership countries need access to long-term financing instruments for their investments, including well-designed guarantee schemes.* Guarantees tend to be concentrated among a few large and medium-size firms and do not yet reach a significant number of smaller and more constrained firms. The GCC financial centers provide one option for deepening long-term finance. The centers in Bahrain, Dubai, and Qatar have already gained significant investment finance capacity. Bahrain leads in syndicated lending and cross-border banking; Dubai has created a corporate bond market. The flexibility offered by financial centers also provides a platform for cross-border banking within the region, which could facilitate links between the pools of wealth in the GCC and the significant investment needs of the rest of the region.

#### **Trade finance: Key selected recommendations**

Short-term:

- **Improve access to trade finance in Partnership countries by developing credit bureaus and credit information exchanges, expanding credit insurance facilities (e.g., hedging instruments, political risk guarantee facilities), easing regulations (e.g., foreign exchange controls for international traders, requirements for SME lending), and promoting SME capacity to access modern trade finance mechanisms.**

Medium-term:

- Promote two-step Murabaha financing by Islamic finance institutions and provide venture capital in the form of Murabaha financing to local banks for SME development.
- Scale up support to trade finance liquidity as well as trade finance insurance and guarantee programs for SMEs in Partnership countries, including financial institutions such as the African Development Bank, the Islamic Development Bank, and the World Bank.

## **DIASPORA ENGAGEMENT**

113. *The Deauville Partnership presents an opportunity to encourage the region's diasporas to contribute to the transition efforts of their origin countries through remittances, technology and skills transfer, and investment.* In particular, diasporas are an untapped asset that can help Partnership countries attract high spillover FDI and upgrade their exports composition toward a higher technological level. Emigrants from Egypt, Jordan, Libya, Morocco, and Tunisia totaled 8.2 million in 2010, many of them living in the G8 countries, Turkey, and the GCC. Moreover, the actual size of the diaspora is larger than the official estimate of migrants. Many migrants are not counted in national surveys, and many descendants of migrants still have emotional ties to the country of their parents and grandparents. Substantial proportions of emigrants hold tertiary education degrees—more than 50 percent of emigrants from Egypt and Jordan and around 20 percent of those from Morocco and Tunisia. More than 70 percent of skilled migration from the Maghreb is oriented toward Europe, while in Egypt and Jordan, skilled migration is mainly oriented toward North America and Europe. Following the democratic transitions in Tunisia and Egypt, the new authorities have begun to reengage with their diasporas, taking steps such as granting voting rights to Tunisians and Egyptians living abroad. Educated and successful migrants should be invited to become more involved in the economic and political life of their home country. This strategy has been recently successfully developed in India, for example, to promote business relationships.

114. ***Remittances, in the form of transfers from migrant workers, are one of the most tangible and resilient sources of income for Partnership countries.*** It is estimated that total remittances to the five Partnership countries amounted to about US\$20 billion in 2010 (World Bank 2010c). Remittances play an important role in reducing the incidence and severity of poverty. In Morocco, for example, remittances account for more than 50 percent of the household budget of the lowest income quintile and reduce by half the probability of being poor. Remittances are also associated with increased household investments in education, entrepreneurship, and health, all of which have a high social return in most circumstances. Yet the economic contribution of the diaspora potentially goes much beyond the transfer of workers' remittances. The diaspora can contribute by stimulating FDI, improving access to foreign capital markets through investment funds and diaspora bonds, providing grants for development, establishing contacts to promote trade and investment, increasing demand for exports (the “nostalgic” trade), and transferring technology and know-how through, for example, professional associations, temporary assignments of skilled expatriates in origin countries, and the return of emigrants with enhanced skills.

115. ***In the aftermath of the Arab Spring, Partnership countries have a new opportunity to better engage with their diasporas and organize themselves at home to make good use of the diaspora potential.*** A lack of interest and understanding, along with scarce data, has traditionally impaired efforts to increase the contributions that diasporas can make to origin countries. Efforts to understand the size and characteristics of the diaspora should be a high priority for the Partnership countries. Government institutions abroad, especially embassies and consulates, can play a key role in reaching out to the diaspora. A recent survey of embassies found that several have little information on the number of diaspora members, that coordination between the embassies and government ministries needs to improve, and that embassy staff need training on how to work with diaspora members. Steps that could improve embassies' engagement with diasporas include outreach programs to gain more information, the training of embassy staff in contacting diaspora members and facilitating investment and trade contacts, and the use of embassies as a vehicle for marketing investment and financial mechanisms such as diaspora bonds. At home, government initiatives have taken various forms, from the creation of ministries dedicated to dealing with migrant communities to the addition of specific functions to such ministries as foreign affairs, interior, finance, trade, social affairs, and youth. In addition, some governments have set up institutions such as councils or decentralized institutions that deal with migrant community issues, with varying degrees of success. The various government programs and initiatives could advantageously be streamlined under a more unified strategy to welcome contributions from an increasingly diverse diaspora. Morocco and Tunisia have dedicated agencies to deal with their migrants abroad, but these agencies have not adapted their services to keep up with demographic shifts. Another important signal would be to allow for dual citizenship and grant voting rights to diaspora members where they do not already have such rights.

116. ***On the financial front, Partnership countries could further mobilize diaspora savings by issuing targeted financial instruments, such as diaspora bonds.*** Diaspora bonds are an innovative instrument that can tap into the emotional ties of the diaspora—the desire to give back—and help lower the cost of financing for development projects back home. To lower the cost and enhance their creditworthiness, the issuance of diaspora bonds could be partially guaranteed by G8 countries and other

Deauville partners. Partnership countries could also mobilize resources from diasporas by encouraging their participation in social security, housing, and microfinance programs. Government could also work to reduce the relatively expensive transaction cost of remittances and facilitate diaspora access to investment opportunities at home by introducing modern, cheaper transfer technology, such as Internet and mobile phone technology, and by improving competition in the remittance markets. Other cost-saving or incentive mechanisms would include establishing one-stop shops for diaspora members and exempting them from taxes and fees on the returns made from their transfer deposits.

117. *Deauville partners could further assist Partnership countries in establishing more dedicated diaspora programs with a view to promoting development in origin countries.* G8 countries have yet to develop well-defined comprehensive programs to facilitate diaspora trade, investment, and technology and skill transfers. Existing programs have focused on small grants or matching grants initiatives. They could usefully be scaled up. Each G8 country and the EU should streamline bilateral pools of initiatives for diasporas from Partnership countries and develop a more coordinated governmental approach to diaspora engagement. The EU should open dialogues (with Egypt and Jordan) and launch negotiations (with Morocco and Tunisia) on mobility partnerships. And the EU should also ensure policy coherence between the proposed DCFTAs and those mobility partnerships. G8 countries could support the creation of a common portal for a remittances price database.

**Engagement with diasporas: Key selected recommendations**

Short-term:

- Strengthen engagement of Partnership countries’ embassies with their diasporas with a view to identifying the diaspora and facilitating investment and trade contacts. Steps include outreach programs to gain more information, coordination with ministerial departments, and training of embassy staff in contacting diaspora members.

Medium-term:

- Establish dedicated diaspora programs in Deauville partners to facilitate diaspora trade, investment, and technology and skill transfers, and promote development in origin countries, in consultation with Partnership countries.
- Harness diaspora savings through the possible issuance by Partnership countries of targeted financial instruments, such as diaspora bonds and housing and microfinance programs.

## 6. PROMOTING INCLUSIVENESS, EQUITY, AND SUSTAINABILITY

118. *The process of integration—like the process of change brought about by technological progress—benefits society at large, but it also generates winners and losers.* To be sustainable, the political economy of trade and FDI requires that the benefits of integration, which are often concentrated in the large cities and among the more privileged sectors of the population, be shared as widely as possible across regions and people. Addressing and dealing with the short-run distribution effects of opening up and technological upgrading would probably be the most critical social challenge facing the Partnership countries in the coming years. Trade and FDI are more than simple exchanges of material goods and services: they have to do with people and their norms and values. Trade partners need to recognize the possible tensions between those societal policies, as they relate for instance to women’s

rights, labor rights, or other human rights, and find ways to ease these tensions over time. There are three priorities for the Deauville Partnership in this area:

- Target *social policies* to help the most vulnerable people manage trade- and FDI-related shocks, address the needs of the unemployed during transition periods, and retrain workers in sectors that lose as a result of integration.
- Develop *regional policies* to connect lagging and remote regions to urban centers, promote internal trade, and help poor people in these areas connect to the places where opportunities are concentrated.
- Promote common *societal policies* in trade and investment rules, including in the areas of women's rights, labor rights, and other human rights.

## SOCIAL POLICIES

119. *Legitimate concerns exist about certain effects of globalization on jobs, wages, and job security. One concern is that globalization may not have provided the same opportunities to all and may even have contributed to rising inequalities within and between societies.* The vision of a greater economic integration of Partnership countries into the global economy would thus need to include appropriate complementary social policies to enhance economic efficiency, promote equity of opportunities to the extent possible, and provide the necessary social safety nets and security systems. Simply removing economic barriers between countries may not be sufficient to produce economically desirable outcomes, either because the presence of market imperfections prevents efficient outcomes or because such outcomes have distributional consequences that make them politically unfeasible. As is well known, there has been a significant increase in the wage premium for skilled labor around the world, a rise in the ratio of skilled-to-unskilled employment in all sectors, and rising relative inequality between the skilled and unskilled.

120. *At the same time, greater economic integration can only explain a small fraction of the general increase in wage inequality observed in both developed and developing countries.* Adjustment costs associated with trade liberalization were a major issue in the 1980s and 1990s, but the issue has receded with the advancement of tariff reforms in most countries. Analyses of the poverty implications of changes in trade policy and, more generally, of the linkages between trade and poverty reduction tend to conclude that changes in trade policies do not often generate large effects for the poor, whether positive or negative, because changes in prices due to these changes are mostly small in the short run. One implication is that the direct effects of trade reform per se on aggregate employment tend to be limited. Much more important are the economic transformation and changes in prices brought about by the related technological progress and technology diffusion. To be sure, policy makers are often concerned about the effects of trade and investment liberalization on overall employment. Yet, given their current high level of unemployment, Partnership countries should expect that new trade and FDI opportunities will translate into investment in tradable sectors and increase formal employment. Whether the impacts of economic integration operate more or less through wages as opposed to

employment depends significantly on labor market institutions, the efficiency of capital markets, and social policies.

121. *An integration agenda nevertheless needs to deal with the possible adverse short-term effects of trade- and FDI-related shocks and ensure that the greatest number benefit from economic integration.* Making integration more beneficial to the poorest households is critical for the sustainability of the reform process. Trade and FDI integration will result in a reallocation of factors of production within and between firms and sectors. This is the source of the efficiency improvements that underpin the gains from trade and investment, but it may also bring with it adjustment costs. There are, therefore, winners and losers. Attenuating the negative effects of integration for disadvantaged groups is an important task for governments, and in principle, the gains from trade generate the resources that governments can use to accomplish this. Partnership countries already have in place comprehensive social programs covering a wide range of policies aimed at preventing, mitigating, and coping with economic hazards. They would gain social cohesion by further strengthening those policies to effectively assist those adversely affected by structural reforms and by better targeting those mechanisms toward poor and vulnerable households. In particular, Partnership countries should receive the necessary support and assistance from Deauville partners to pursue three strategies:

- *Promote employment by reducing segmentation in the labor market* through labor market reforms, including specific measures to reduce informality, promote school-to-work transition, increase the efficiency of active labor market policies, and improve migration outcomes (Özden and Schiff 2006). One of the main goals of a trade and FDI strategy in Partnership countries is to improve employment creation and job quality through labor market reforms, including efficient intermediation of labor demand and supply. In addition to employment in national markets, an integration strategy also aims to promote employability in global and regional labor markets through improved migration management.
- *Strengthen social insurance coverage*, including pensions, unemployment insurance, and disability benefits. Social security coverage in Partnership countries, when provided at all, covers a very limited number of people; benefits for the affiliated are usually large, often redistributing from poorer to richer beneficiaries, and the existing rules often give incentives to game the system. The processes of economic transformation and structural change make unemployment insurance an increasingly relevant feature of social security, and having such insurance in place can open the way for a domestic dialogue on reform of labor market regulations. Efficient pension systems and well-functioning unemployment insurance systems are important enablers for dynamic labor markets and, ultimately, growth.
- *Improve the targeting of social safety nets*, including conditional and unconditional cash transfers, youth programs, child protection, and social care. Social safety nets are a crucial component of a well-functioning economy, serving as an instrument to enable investment in human capital, manage household risk, and promote equity. Partnership countries spend significant amounts on social safety nets, but mostly on nontargeted subsidies that are inefficient, favor the rich, and can result in significant fiscal liabilities in times of crisis. When well targeted, social safety nets not only protect against risk, but can also offer incentives to invest in human

capital through health and education of children and training of young entrants in the labor markets, for example. A number of MENA countries have launched innovative approaches, such as social funds, to allow communities to allocate social spending according to their own priorities.

#### **Social policies: Key selected recommendations**

Short-term:

- **Improve the targeting of social safety nets in Partnership countries, such as conditional and unconditional cash transfers, youth programs, child protection, and other social benefits, including through innovative approaches to allow communities to allocate social spending according to their own priorities (such as social funds).**

Medium-term:

- Reduce segmentation in Partnership countries' labor markets through labor market reforms, including specific measures to reduce informality, promote school-to-work transition, increase the efficiency of active labor market policies, and improve migration outcomes.
- Strengthen social insurance coverage in Partnership countries, including unemployment insurance.

## **REGIONAL POLICIES**

122. *Extending the benefits of trade and FDI to lagging regions within Partnership countries is another key dimension of an inclusive and sustainable integration strategy.* In Partnership countries, metropolitan areas (Amman, Cairo, Casablanca, and Tunis) and coastal regions (Aqaba, Alexandria, and Tangier) have captured most of the gains from past reforms and episodes of growth acceleration. Peripheral geographic areas, particularly those that are remote and sparsely populated, have lagged behind. Unless strategies are developed to improve competitiveness and the quality of logistics infrastructure and services at the subnational level, large numbers of people may not benefit from globalization. This does not mean that economic activity in Partnership countries should necessarily be balanced or symmetric, but rather that people in remote regions should have more opportunities to connect to those places where agglomeration (e.g., markets, employment) occurs.

123. *Partnership countries therefore need to steer a careful course between fostering concentration, which encourages long-term productivity gains, growth, and jobs, and encouraging dispersion, which leads to more balanced regional development.* Concentration forces, in the form of industry spillovers, labor market pooling, access to intermediate inputs, and proximity to a large market, serve to increase productivity and income in the long run (World Bank 2009b). However, such concentration might induce a widening of income inequality between regions of a country and also a worsening of the situation of urban dwellers through the formation of slums and an increase in crime and unrest (Glaeser, Resseger, and Tobio 2008). From a sociopolitical perspective, spatial disparities can have worrisome effects. They can become a source of political grievance for residents of low-income areas. The relationship between concentration of economic activities and sustainable and inclusive economic growth is therefore complex and depends on several factors, such as the initial level of development and the relative influences of concentration and dispersion forces over time. Moreover, the empirical literature suggests that such a relationship is neither unidirectional nor linear. While the

severity of poverty in Partnership countries is generally lower than in other developing countries, it is increasing more rapidly in extent. As in other regions, poverty is more severe in rural areas but is increasing more rapidly in urban areas.

124. ***The risk of a core-periphery divide in the pursuit of further economic integration may also occur at the regional level between Partnership countries and their main trade partners.*** Partnership countries, which tend to be at the periphery of the Euro-Mediterranean area, may understandably be concerned that their nascent industries could migrate to the EU core or other advanced markets in order to benefit from agglomeration economies, thereby dashing the hope of income convergence with more advanced countries. In that case, the spatial concentration of economic activity would create circular forces that encourage further spatial concentration, such as with the emergence of industrial clusters. On the other hand, EU countries, especially those already plagued with high unemployment and deindustrialization, may fear the risk of “social dumping” due to lower wages and social conditions in Partnership countries and other dispersion forces that favor the geographic spreading out of economic activity. The classic example is the price of land, which affects the price of housing, office space, and so on, making built-up areas less competitive and attractive (Puga and Venables 1998).

125. ***A well-designed policy package focusing on a region-specific growth strategy along with transport and ICT infrastructure could help reduce concentration.*** There is no doubt that the best way to address these issues is to make the lagging regions attractive to producers, investors, traders, and consumers. This includes better access to social services and an improved business climate to enhance private sector interest in these areas. One needs to match the policy package to the place, taking into account the unique characteristics and distinctive assets of each lagging area (OECD 2011). Examples include cross-border trade facilitation in lagging regions, city-level partnership arrangements between migrant-sending and destination countries, and integrated service delivery strategies matched to local inward FDI projects. Of prime importance is to break the isolation of remote areas by improving their connections to the poles of development, in particular by connecting farmers to markets in urban centers and facilitating the movement of rural labor to employment sites. Transport infrastructure on rural roads and trade facilitation can thus play a crucial role in mitigating the effects of concentration. Beside transport, Partnership countries should focus on supporting the rural penetration of ICT in the form of mobile phones, Internet access, and other communication technologies. By enabling people to perform some tasks remotely, ICT can ease the isolation of rural areas and reduce pressures for urban migration.

### Regional policies: Key selected recommendations

Short-term:

- **Support the rural penetration of ICT in Partnership countries in the form of mobile phones, Internet access, and other communication technologies.**

Medium-term:

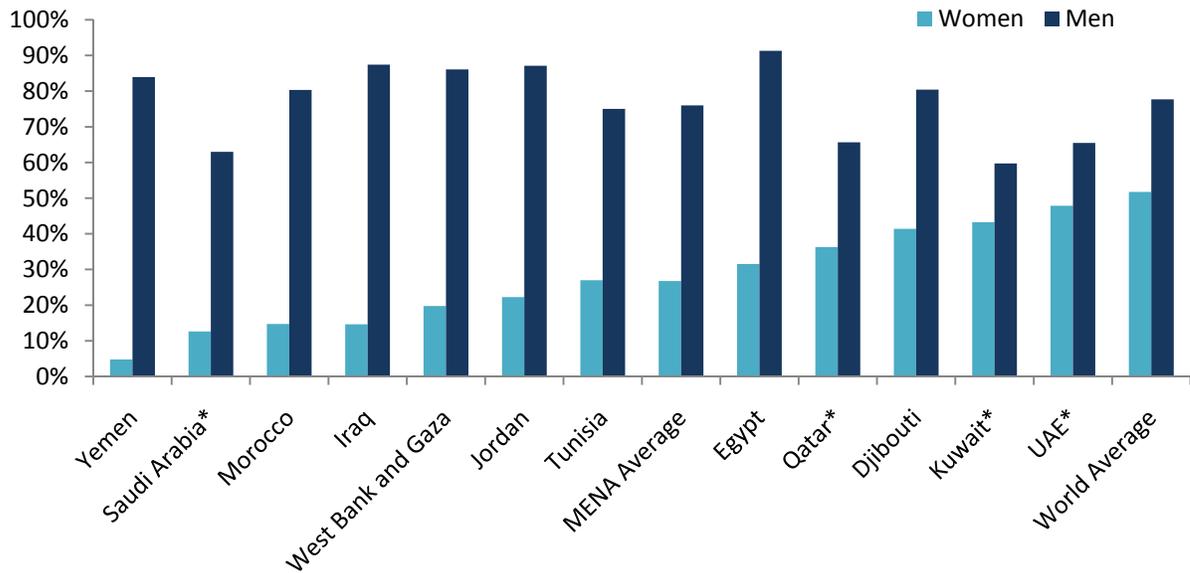
- Develop a regional development strategy in Partnership countries to make the lagging regions attractive to producers, investors, traders, and consumers, by means of better access to social services and an improved business climate to enhance private sector interest in these areas.
- Improve transport infrastructure on rural roads and trade facilitation in lagging regions to break the isolation of remote areas and connect them to poles of development, in particular by connecting farmers to markets in urban centers and facilitating the movement of rural labor to employment sites.

## SOCIETAL POLICIES

### *Women's rights*

126. *Since the beginning of the Arab Spring, women have been at the forefront of calls for change in the political and economic spheres.* In all Partnership countries the female labor force participation rights are very low (Figure 9) and there is a growing demographic of young, educated women who want to work. These women could be direct beneficiaries of a trade and FDI integration strategy that creates more jobs. Indeed, the most direct positive impact of economic integration on women's welfare is through increased female employment. This leads to further indirect benefits over time, as women who earn their own income typically acquire greater bargaining power and agency in the household and the society (Duflo and Udry 2004). But there remain considerable rigidities and constraints in the labor markets of Partnership countries that could limit women's access to new jobs. The growth of trade-oriented, labor-intensive sectors such as manufacturing and services is one of the best options open to Partnership countries looking to increase the level of participation among women and reduce their levels of unemployment.

Figure 9. Labor force participation rates by gender



Source: World Bank, World Development Indicators, <http://data.worldbank.org>.

\* Share of citizen population.

127. *To ensure that women gain directly from the employment opportunities created by trade and FDI, Partnership countries should look beyond the simple lack of jobs to the factors constraining women's access to employment.* The legal and regulatory environment needs to be reformed with a view to not only fostering new job creation and a competitive labor market, but also making these new jobs available to women. Governments should work to reduce the distortionary effect of the public sector on the private labor market and reform education to better equip young women with the skills required by industry. Certain laws must change because they discourage firms from hiring women; these include requirements for employer-funded maternity leave and restrictions on women working in certain industries or at night. Clearly, women will benefit little from new manufacturing jobs if they cannot work night shifts. Moreover, entrenched social norms and prejudices about women's abilities and proper roles continue to deter women from taking jobs outside the home, or their families from allowing them to do so. These norms include limitations on women's mobility, enforced through guardianship laws, among other means. Governments need to work to ensure that laws and the judicial system protect women from harassment in the workplace and on their way to work; only visible enforcement of these protections will begin to change attitudes. As illustrated by the history of development in East Asia, women need mobility and flexibility of choice in order to benefit from new jobs in the tradable sector. Governments should consider how the current legal and social environment might hamper this, and seek to redress such constraints.

128. *Making major changes to the status of women remains an important unfinished business agenda in Partnership countries.* There is, moreover, a concern that efforts to advance women's rights may be halted or even reversed as new governments come to power. This is particularly the case in Tunisia and Egypt, where notable reforms to women's rights were a dimension of the previous regimes'

modernizing agendas. These reforms could be targeted by parties looking to signal a break with the past. Short-run volatility associated with economic reform and opening of markets may well exacerbate the political pressures in this regard. The Deauville Partnership is an opportunity for dialogue on the best ways not only to defend the rights of women in Partnership countries, but to enhance them. Partners have a key responsibility to provide the necessary assistance.

### *Labor rights*

129. ***Pursuing core labor standards simultaneously with trade and FDI could help spread the benefits of globalization more broadly, discourage the worst abuses of workers, and increase public support for trade agreements and economic integration.*** One key to realizing the complementarities between open trade and labor rights and avoiding potential negative effects is to distinguish “core” labor standards from others. Some labor standards—for example, wages and health/safety regulations—clearly will have to vary with countries’ levels of development and local standards of living. However, the core labor standards set forth in the Declaration on Fundamental Principles and Rights at Work that was issued by the International Labour Organization (ILO) in 1998 are meant to be upheld by all countries, regardless of their level of development. The ILO document lists four core labor standards as deserving of universal application:

- Freedom of association and “effective recognition” of the right to collective bargaining
- Elimination of forced labor
- Effective abolition of child labor
- Elimination of discrimination in employment

130. ***While members of the Partnership are committed to those core labor standards, the Deauville Partnership could support their effective implementation.*** In line with the aspirations of the Arab Spring, the Deauville Partnership could provide a framework for financial and technical capacity-building assistance to improve implementation of core labor standards in Partnership countries. Precedents do exist. A 2009 investigation by the US Government Accountability Office looked at the implementation of four US preferential trade agreements (PTAs), with Chile, Jordan, Morocco, and Singapore. It concluded that free trade agreement negotiations spurred some labor reforms in each of the selected partners, but that progress has been uneven and US engagement limited. An example cited was Morocco’s enactment of a long-stalled overhaul of its labor code. Partnership countries should receive the necessary assistance and support to enforce their labor laws aimed at promoting core labor standards and fighting labor abuses.

### *Human rights*

131. ***A shared understanding among partners of the human values embodied in the goods or services being exchanged would also improve the chances of success of the integration strategy.*** . Open trade and human rights are based on the same values: individual freedom and responsibility, nondiscrimination, transparency, welfare. Both are aimed at advancing human liberties and opportunities. International obligations undertaken by countries must therefore be simultaneously respected, whether in trade or human rights. If designed carefully, human rights provisions in trade and

investment relations can work both to improve governance and to empower people to claim their rights (Aaronson 2011). Freedom of exchange is also a means to promote other dimensions of freedom (Chauffour 2009). Openness to trade likely leads to a higher rate of interchange of ideas and information among countries (Sykes 2003). In turn, as people in nations with fewer rights and freedoms become aware of conditions elsewhere, internal pressures for improvement may grow.

132. ***International agreements linking trade and human rights have the potential to support homegrown change as they set up mechanisms for dialogue, allow civil society in multiple countries to foster effective commitment to international norms.*** Many of the world's most important trading partners, from the United States, Canada, and the EU to Brazil and Chile, include human rights language in their PTAs. The EU has been the most enthusiastic proponent of the inclusion of human rights provisions in PTAs and has negotiated human rights clauses in all its association agreements with Partnership countries. The United States has focused on promoting transparency (access to information), public participation, and due process. Although the language in these chapters varies from agreement to agreement, in general the passages are framed in the language of human rights. They require governments to publish, in advance, laws, rules, procedures, and regulations affecting trade, thereby giving "persons of the other party that are directly affected by an agency's process . . . a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action." These agreements also contain a section on review and appeal, designed to give the parties a reasonable opportunity to support or defend their respective positions.

133. ***Drawing on international experience, Partnership countries may see the introduction of human rights provisions in trade agreements as a way to secure democratic change for the long haul.*** Those normative provisions may encourage future partner governments to allow public participation and continue to encourage citizens to engage and challenge policy makers. For instance, since signing free trade agreements with the United States, PTA partners Chile, the Dominican Republic, Jordan, Mexico, and Morocco have established channels through which organized civil society can comment on trade policies (Aaronson and Zimmerman 2007). Deauville partners could usefully support Partnership countries in promoting a trade and FDI agenda based on a core set of fundamental freedoms. This would involve enhanced cooperation to monitor and review Partnership countries' obligations and increased support for their effective implementation.

134. ***Indeed, the Deauville Partnership is ultimately a vehicle for dialogue, cooperation, and support.*** Promoting a trade and FDI strategy that is embedded in shared human values, including respect for fundamental freedoms, will be a way to unify the three pillars of the partnership: the trade and commerce pillar would converge with the governance and finance pillars to support the democratic transition and homegrown strategies for sustainable and inclusive growth.

### **Societal policies: Key selected recommendations**

Short-term:

- **Reform the legal and regulatory environment in Partnership countries to facilitate women's participation in the labor force and make more jobs available to women by, inter alia, reducing the distortionary effect of the public sector on the private labor market, reforming education to better equip young women with the skills required by industry, amending laws that discourage firms from hiring women (e.g., employer-funded maternity leave and restrictions on women working in certain industries or at night), revising limitations on women's mobility (e.g., guardianship laws), and protecting women from harassment in the workplace and on their way to work.**

Medium-term:

- Leverage future deep and high-quality trade agreements with Deauville partners as a framework to facilitate coordination of approaches in promoting and implementing core labor rights in Partnership countries pertaining to freedom of association, elimination of forced labor, effective abolition of child labor, and elimination of discrimination in employment.
- Similarly, leverage future deep and high-quality trade agreements with Deauville partners as a framework to facilitate coordination of approaches in promoting and protecting fundamental freedoms in Partnership countries, including on trade governance issues such as transparency (access to information), public participation, and due process.

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