Global Rules for Business: Challenges to Firm Competitiveness and Opportunities for Success

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Working Paper No.43

October 2000

This paper was prepared for the workshop, "What Makes Your Firm Internationally Competitive," organized by ECES for the Third Meeting of the Mediterranean Development Forum held in Cairo on March 5-8, 2000.

Abstract

Rapid changes in the global economic environment have led to new challenges and opportunities for firms in the MENA region. In response to these developments, this paper briefly reviews how MENA countries have fared in the global economy and outlines the challenges and opportunities arising from these global changes. The paper starts by reviewing several indicators, which show that MENA countries have fared poorly compared with other developing regions. In order to help MENA firms to prepare themselves to meet this competitive challenge and benefit from available opportunities, the authors suggest the following: first, firms can call on the governments to accelerate efforts to improve the institutions governing trade and investment and trade-related infrastructure; second, they can resist the temptation to use the transition periods allowed in regional agreements to continue business as usual. The paper concludes by highlighting the importance of the government's role as effective partners of the private sector. This necessitates giving firms clear signals about the nature and magnitude of changes that are going to occur, as well as making the complementary institutional changes needed to implement the rules effectively and fairly.

ملخص

أبرزت التغيرات السريعة والمتلاحقة التى يشهدها النظام الاقتصادى العالمى العديد من التحديات والفرص الجديدة أمام المشروعات بمنطقة الشرق الأوسط وشمال أفريقيا. وتحاول هذه الورقة التعرف على وضع بلدان الشرق الأوسط وشمال أفريقيا فى الاقتصاد العالمى، وكذلك تحديد التحديات والفرص المتاحه أمامها. وتبدأ الورقة باستعراض بعض المؤشرات التى توضح التراجع النسبى للإداء الاقتصادى لبلدان الشرق الأوسط وشمال أفريقيا مقارنة ببعض المناطق النامية الأخرى. وتطرح الورقة بعض المقترحات لمساعدة هذه البلدان على مواجهة التحديات لتى تواجهها وللإستفادة من الفرص المتاحة أمامها. فعلى سبيل المثال تشير الدراسة الى أهمية قيام االمنشآت بحفز الحكومات على زيادة الجهود المبذولة فى مجال تطوير امؤسسات الخاصة بالتجارة والاستثمار والبنية الأساسية المرتبطة بالتجارة، والى أهمية الأنتباه الى عدم الأنزلاق فى مصيدة الفترات الإنتقالية المنصوص عليها فى إتفاقيات التجارة الإقليمية؛ وهو ما يعنى ضرورة البدء الفورى فى تطبيق برامج التحديث وإعادة الهيكلة. وفى النهاية تؤكد الدراسة على أهمية دور الحكومات كشريك فعال للقطاع الخاص، وذلك من خلال إعطاء إشارات واضحة عن طبيعة وحجم التغيرات المستقبلية، فضلاً عن القيام بالإصلاحات المؤسسية المكملة لتنفيذ هذه التغيرات على نحو فعال وعادل.

I. Introduction

Rapid changes in the global economic environment have brought new challenges and opportunities to firms in the MENA region. In response to these recent developments, this paper begins in Section II by briefly reviewing how MENA countries have fared in the global economy. The study then outlines the challenges and opportunities arising from the changing global economic environment in Section III, and follows in Section IV with an evaluation of how firms in MENA are currently facing these challenges. Finally, the paper suggests in Section V which private and public actions will be necessary in order for the MENA region to take advantage of the opportunities offered by the global trading system, and offers its final conclusions in Section VI.

II. How Do MENA Countries Fare in the Global Economy?

The goods and services feeding into production processes have become increasingly geographically de-linked and internationalized. This phenomenon has been facilitated by the decreasing cost of doing global business resulting from reduced uncertainty in foreign direct investment, declines in traditional transport costs, and remarkable technological improvements in communications.

Table 1. Tariff Rates By Region (%)

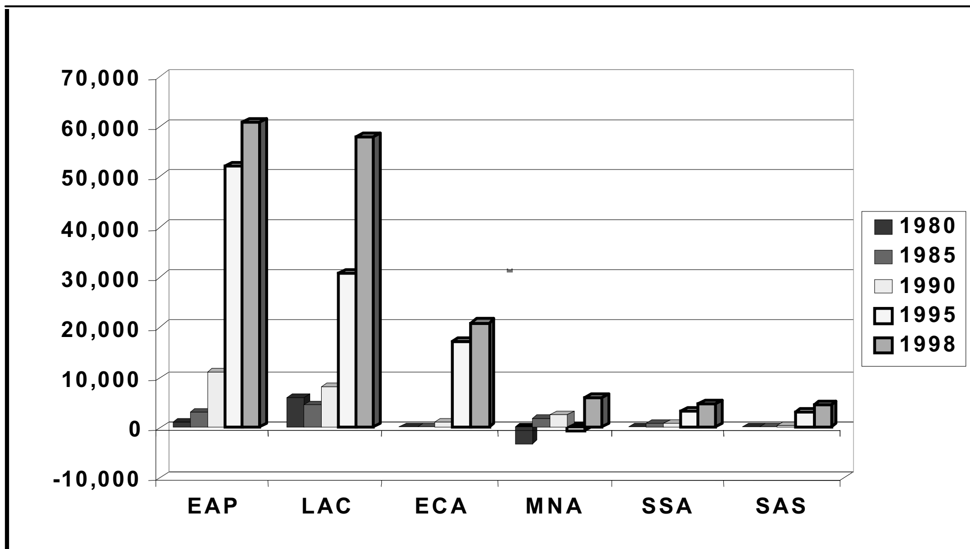
Exporting Region	**Importing Region**						
	High Income	East Asia	South Asia	LAC	MENA	SSA	Rest of Africa
Manufactures							
High Income	1.1	10.7	56.4	8.9	12.3	12.4	17.3
East Asia	4.6	12.7	62.4	14.6	12.2	18.0	28.6
South Asia	7.8	7.9	62.9	13.9	12.1	23.8	17.7
LAC	1.9	6.4	58.3	11.1	12.1	13.9	15.2
MENA	4.3	6.7	63.9	11.0	11.4	13.1	18.5
SSA	2.7	9.1	58.4	12.1	11.6	18.4	6.6
Rest of Africa	5.9	4.6	62.3	14.9	9.8	15.1	19.6
Agriculture							
High Income	15.9	31.9	26.1	2.9	15.1	16.2	16.0
East Asia	13.3	16.9	55.0	4.4	17.6	9.0	18.1
South Asia	10.5	18.9	21.5	8.6	21.0	3.2	15.9
LAC	14.3	16.8	49.7	8.1	10.5	7.5	15.3
MENA	10.8	14.3	58.0	8.5	15.5	22.1	23.4
SSA	13.7	28.3	62.2	7.4	12.1	12.8	12.2
Rest of Africa	31.9	17.7	16.5	9.9	19.1	5.8	13.8

Note: The tariff rates do not reflect the GSP rates.
Source: GTA

MENA countries are now faced with transformed and more competitive economic environments in other developing countries. The East Asian economies – followed by most Latin American countries in the late 1980s and 1990s – liberalized their economies and adopted more outward oriented policies. This process has not yet fully taken place in MENA, placing MENA producers and exporters at a cost disadvantage and reducing their competitiveness. Although most MENA countries have undertaken tariff and tax reforms since the 1980s, progress has been slow and uneven (Table 1).

The impact of these developments has resulted in three distinct patterns. First, international production sharing between developed and developing countries has increased substantially during the past two decades. Production sharing is partially reflected in the substantial increase in foreign direct investment (FDI) flows from developed to developing countries, with the majority directed to East Asian and Latin American Economies. The output share of affiliates of multinationals in developing country GDP increased from 4.4 percent in 1982 to 6.3 percent in 1995.[1] MENA countries have fared poorly in comparison (Figure 1).

Figure 1. Net Inflows of FDI, in US$ million



Source: SIMA Data Base, WDI & GDF Central

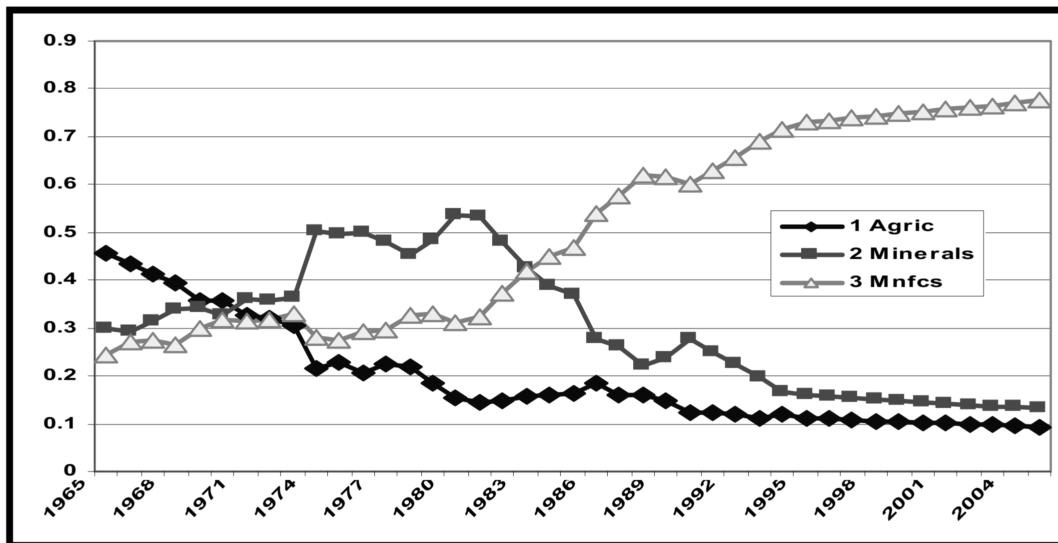
Intra-industry trade — often a measure of increased production sharing and specialization — also highlights this under-performance. Between 1985 and 1997, MENA countries

[1] Mustapha K. Nabli and Annette I. De Kleine, 1998, pg. 24.

had relatively low levels of intra-industry trade and show little change compared to Korea, Brazil, Malaysia and Taiwan (Yeats and Ng, 1999).

Second, there has been a substantial increase in manufacturing exports from developing countries since the mid-1980s (Figure 2). In addition, manufactured goods trade among developing countries has increased from just over 30 percent to over 70 percent (Hertel and Martin, 1999). This increase in importance is very widely distributed among developing countries, but MENA and Sub-Saharan Africa have lagged with 40 percent or less of manufactured exports.

Figure 2. Share of Merchandise Exports from Developing Countries



Source: Hertel, Thomas A. and Will Martin. 1999. "Would Developing Countries Gain from Inclusion in the WTO Negotiations?" paper presented at Conference on WTO and The Millennium Road. Geneva.

Third, services trade has increased substantially, and developed countries are increasingly outsourcing services activities to developing countries. Jamaica, for example, has been highly successful in attracting billing and back office activities to its Montego Bay Export Processing Zone. India has grown famous for its software clusters in and around Bangalore. Once again, the majority of the expansion of trade in services has accrued to East Asia, Eastern Europe and Latin America, with the MENA region as a distant fourth (See Figure A1 in Appendix A). While the MENA countries have historically provided labor to each other and the EU, and have exported some construction services, they have not really exploited opportunities in alternative services

exports. Recent indicators show that, with the exception of Egypt's commercial services exports, trade in commercial services is generally lacking in MENA countries (See Figure A2 in Appendix A).

MENA's speed of integration with the global economy has lagged behind other regions. Only one MENA country – Morocco – is a fast integrator[2]. All other MENA countries are either moderate, weak or slow integrators (Table 2). Examining the MENA region's lackluster period of 1985-1998 shows that while there has been some growth in exports, (notably a threefold increase in the case of Tunisia), exports from Egypt and Jordan stagnated in the 1990s (See Figures A3-A4 in Appendix A). The trends do not match up with the sharper increase in imports and exports in other regions.

Table 2. Middle Income Speed of Integration

Fast Integrators	Integration Pace		MENA Integrators	Integration Pace
Argentina	0.59		*Fast*	
Chile	0.65		Israel	0.66
Costa Rica	0.73		Morocco	0.97
Czech Republic	0.46		*Moderate*	
Hungary	0.95		Iran	0.20
Jamaica	1.19		Syria	0.42
Korea, Rep.	0.63		Tunisia	0.16
Malaysia	1.80		UAE	-0.18
Mauritius	2.35		*Weak*	
Mexico	1.44		Egypt	-0.19
Morocco	0.97		Jordan	-0.39
Philippines	0.99		*Slow*	
Poland	0.58		Algeria	-1.51
Sri Lanka	0.95		Iraq	-1.68
Thailand	2.12		Oman	-1.00
Turkey	1.87		Saudi Arabia	-3.40

Note: Speed of integrator index is derived from changes between the early 1980s and early 1990s in four indicators: the ratio of real trade to GDP, the ratio of foreign direct investment to GDP, Institutional Investor credit ratings, and the share of manufactures in exports. The speed of integration index is the simple average of changes in the four indicators over the period (each expressed as a standard deviation from its average).
Source: GEP 1996, p. 24-25.

A review of cross-regional trade patterns over the past ten years reveals some interesting trends. Some major Latin American and East Asian economies have made

[2] A speed of integration index can be derived from changes between the early 1980s and the early 1990s in four indicators: the ratio of real trade to GDP, the ratio of foreign direct investment to GDP, institutional investor credit ratings, and the share of manufactures in exports. The speed of integration index is the simple average of changes in the four indicators over the period (each expressed as standard deviation from its average).

consistent inroads into leading MENA markets (Brazil, Argentina, China, S. Korea, Indonesia, Taiwan). However, the MENA exporters have not made significant in-roads into the major Latin American Country (LAC) and East Asian economies. Furthermore, no major links to the rest of Africa (with its major economies, South Africa and Nigeria), or to South Asia (India) are evident for any of the MENA countries.

III. Global and Regional Rules: Challenges and Opportunities for the MENA Region

MENA firms will face significant new challenges as multilateral and regional agreements governing international trade come into play. For the region as a whole, three important rule-setting processes are taking place simultaneously. First, the implementation of the Uruguay Round agreements and any follow-up to the Seattle meeting of the World Trade Organization (WTO) held on November 30, 1999 will affect market access and import competition across a wide range of manufactured, agricultural and services sectors. Second, agreements with the European Union (Euro-Med) are being concluded by an increasing number of MENA governments. And third, regional trading blocs with other Arab States (the Arab Free Trade Area, AFTA, and the Gulf Cooperation Council, GCC) are entering the picture. Each of these pose a potential competitive challenge – and offer substantial new opportunities – to MENA producers.

The WTO Uruguay Round Agreement

MENA countries are recent arrivals to the WTO.[3] Algeria, Lebanon, Oman, Saudi Arabia and Yemen are currently WTO observer governments, and all of these countries have applied to join the WTO, except Yemen. With the exception of Egypt, MENA countries did not actively participate or engage in setting out the agenda for the Uruguay Round, and not all MENA WTO members may be fully able to do so in the new round.

The Uruguay Round commitments have clarified the liberalization of trade regimes in agriculture and manufacturing products, and have provided a basis for the 'rule of law' in international trade. MENA WTO members are committed to binding agricultural and

[3] MENA WTO members: Bahrain – Jan. 1995; Egypt – June 1995; Kuwait – Jan. 1995; Morocco – Jan. 1995; Qatar – Jan. 1996; Tunisia – March 1995; UAE – April 1996; and Jordan – Dec. 1999 (WTO).

industrial tariffs[4] (see Table 3). While their binding commitments covered 100 percent of agricultural products and 75-98 percent of manufactured goods (except for Tunisia's 53 percent), many chose binding tariff ceilings much higher than their applied rates (see Table 4), providing discretionary power to policy makers to protect sub-sectors and special interests.

Table 3. Tariff Bindings by Arab Countries Before and After the Uruguay Round (% of total tariff lines in country's tariff schedule; harmonized system (HS) basis)

	Agricultural Products[1] (share in total)		**Industrial Products[2] (share in total)**		**Total (share in total)**	
	Before	*After*	*Before*	*After*	*Before*	*After*
Bahrain		100		70		75
Egypt[3]	3	100	3	80	3	97
Kuwait		100		95		98
Morocco		100		95		98
Qatar[4]		----	----	----	----	----
Tunisia[5]	10	100	16	45	15	53
UAE		100		95		98

Notes: [1] The product coverage comprises the products defined in Uruguay Round Agreement on Agriculture (HS, chapters 1 -24, excluding fish and fish products). [2] The product coverage is as defined in the U.R. (HS, chapters 25 -97, including fish and fish products, and excluding crude petroleum). [3] Egypt's pre-Uruguay Round rates of biding are from GATT (1992). [4] The list of Qatar's concessions were not included in the Final Act of the U.R. [5] Tunisia's pre-Uruguay Round bindings are from GATT (1994a).
Source: The Uruguay Round and the Arab Countries, Said El -Naggar.

Table 4. Bound Tariffs (Upper Ceiling) on Industrial and Agricultural Products Before and After the Uruguay Round (% ad valorem)

MENA Countries	**Applied Tariff Rates Before Uruguay Round**		**Bound Tariff Rates After Uruguay Round**	
	Industry	*Agriculture*	*Industry*	*Agriculture*
GATT Members				
Bahrain	20	20	35	35
Egypt	100	153	60	80
Kuwait	4	4	100	100
Morocco	45	45	40	289
Qatar	----	----	----	----
Tunisia	73	73	90	200
UAE	4	4	40	40
Non-GATT Members				
Jordan	150	150	----	----
Saudi Arabia	30	30	----	----

Source: The Uruguay Round and the Arab Countries, Said El -Naggar

[4] Some, like Egypt and Morocco also committed to tariffication of non-tariff barriers. Morocco and Tunisia also conceded reductions in aggregate measure of support. In terms of domestic support to agriculture, Morocco and Tunisia are committed to phasing out subsidies to inputs, including fertilizer, pesticide, animal feed, seeds, and irrigation water, by 2005. Egypt further conceded to non-tariff concessions in industrial products. Arab countries were not scheduled for reductions in export subsidies to agriculture because they have shown that they do not maintain them.

Yeats (1996) notes that "the Uruguay Round made major progress in removing non-tariff measures (NTBs) facing middle Eastern exporters – especially in agriculture, textiles and clothing. As a result of what was achieved, the average OECD NTB coverage ratio for Middle East exports should fall from ten percent to between one or two percent. The decline in the coverage ratio for Egypt is dramatic. Prior to the Round, 32 percent of Egypt's exports to the OECD faced NTBs – this share should fall to about two percent after the Multi-Fiber Arrangement (MFA) and agricultural restrictions are removed."

There were also reductions in tariffs facing Middle Eastern exporters. In manufactured goods, there was a 40 percent cut in industrial countries' tariffs, with an increased binding coverage from 94 to 98 percent of all imports. This translates into an average tariff reduction of approximately 2.4 percent to 4.0 percent. However, the reductions in major sectors of importance to the developing countries such as textiles, clothing, footwear and transport equipment were lower than average.

Yeats' (1996) analysis suggests that overall, Middle East exports should increase by $800 to $900 million as a result of the Uruguay Round. However, the positive impact may be uneven across MENA countries, as the removal of MFA restrictions will render the textiles and clothing markets much more competitive. On the other hand, net food importers (for instance Egypt) could be adversely affected by the higher international food prices that may result from the Uruguay Round.

In the General Agreement on Trade in Services (GATS), Arab countries generally granted concessions to foreign service suppliers in sectors where they held a comparative advantage such as tourism. Opening markets to foreign service suppliers also occurred in sectors where Arab countries could acquire technology and knowledge transfers and efficiency gains could be made. In the sectors where domestic markets were opened, explicit limitations were detailed. Specifically, limitations were applied to the supply of foreign services through commercial presence and entry and stay of people supplying services and to equity participation by foreign investors (see Table 5).

Table 5. Extent of Commitments to Open Markets for Trade In Services by Arab Countries

Country	Commitment within Sector/Subsector	No. of Service Activities within Sector/Subsector
Bahrain	Insurance/reinsurance	4
Egypt	Construction and engineering, tourism and travel services, banking, insurance/reinsurance, maritime transport and auxiliary services	28
Kuwait	Business, construction and engineering, environmental services, health-related and social services, tourism and travel, recreational and sporting services	44
Morocco	Business, telecommunications, construction and engineering, environmental services, banking, insurance/reinsurance, tourism and travel services, air and road transportation	41
Qatar & UAE[1]	n/a	n/a
Tunisia	Banking, insurance/reinsurance, tourism and travel services	11

Note: [1] Qatar and the UAE did not submit their schedules of commitments as of April 15, 1994.
Source: The Uruguay Round and the Arab Countries, Said El -Naggar

The Post-Seattle WTO Environment

While the Seattle WTO Ministerial meetings failed to launch a new round of negotiations, MENA firms can benefit from further liberalization possible through the "built-in agenda" on agriculture and services. Most MENA countries show a strong comparative advantage in fruits and vegetables. Greater access to markets will present them with substantial opportunities to expand production and exports. Furthermore, greater access to other developing countries' (both regional and worldwide) markets will provide for a more differentiated export market. Further liberalization of services can provide opportunities for the MENA countries to become back-offices to European firms (especially – but not limited to – France). Ireland and Jamaica have successfully developed this service sector, based on low cost English language clerical and information processing skills. Construction services also hold potentially significant gains for MENA, especially if progress is made to ease the movement and temporary employment of workers in other countries.

Regional Agreements: Euro-Med, AFTA and the GCC

The revival of regional arrangements such as Mercosur, GCC, AFTA, ASEAN, NAFTA, and APEC together with the proliferation of bilateral Free Trade Areas such as Euro-Mediterranean agreements have changed the pattern of preferential market access,

investment and consequently, trade.[5] The emergence of Eastern Europe and the rather rapid integration prospects of some Eastern European economies into the EU may herald the rise of potential competitors to the MENA countries for EU markets and FDI.

The EU is a major trade partner throughout the MENA region. Neighbor/regional trade partners are not a significant factor, except for Jordan and Syria. In fact, for many MENA countries, the EU has continued to be the only major trade partner. This trade dependency (on both export and import sides) is especially evident in the cases of Tunisia and Algeria, with the obvious EU partner France. Morocco's dependence to the EU is a bit more attenuated, though distinct, and is bound to increase with its recent signing of bilateral FTA agreement with the EU.

The Euro-Mediterranean Agreements

Unlike past arrangements, the current Euro-Mediterranean agreements initiated in 1995 require reciprocity in matters of trade liberalization. They set a well-defined time frame (12-15 years) and intermediate steps leading to a free trade area between each of the Southern Mediterranean (SMR) countries and the EU for non-agricultural products. Elimination of non-tariff barriers is set to take effect upon signing of the agreement, while tariffs are to be removed within 12 years. The EU continues its policy (in existence since the early 1970s) of granting free access to virtually all manufactured products exported by these countries and of providing limited preferential access for their agricultural exports. There is reciprocal right of establishment for investors. Morocco, Tunisia, and Jordan have already agreed to adapt their regulatory framework to approximate that in the EU in the areas of competition, government procurement, subsidies, and technical standards; and will strengthen cooperation on migratory issues.

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[5] The revival of regionalism – as witnessed in the nineties in both developing and developed countries - often leads to trade creation and trade diversion. Trade diversion from non-member exporters to member exporters translates into loss of markets and market shares for non-members and a higher cost of goods for consumers of the Regional Integration Agreements (RIA). We have examples in Mercosur (Yeats, 1997) and the Andean Pact (Madani, 1999; Yeats, 1999). Since the revival of the Andean Pact in 1991, the share of imports from member countries (especially manufacturing imports) has risen sharply compared to the imports from the rest of the world, signaling the potentially strong pull of regional arrangement schemes. Yeats (1997, 1999) finds that this pull has affected the production structure of the Mercosur and Andean Pact countries by providing them with incentives that draws them away from their international comparative advantage and towards production for and sale in each other's market. Madani (1999) finds that this increased manufactures imports from partner countries does not seem to affect industrial productivity.

The free-trade area is expected to generate significant long-term economic benefits for the region, but it will also involve transitional costs. Over time, welfare gains will accrue as trade liberalization reduces the anti-export bias present in many of the SMR countries' trade regimes and incentives for industrial restructuring increase. Southern Mediterranean countries may become more attractive to foreign investors if there is a positive credibility effect associated with being "locked into" a liberalization schedule with a major regional trade grouping.

Gains in the manufacturing sector will be limited since most SMR countries' manufactured goods already have free access to the EU. However, if the agreements were to allow substantially increased access to European markets for agricultural products and for those manufactured products currently subject to barriers--products in which the SMR countries have a comparative advantage, such as textiles and clothing--the benefits to the SMR countries would be substantially higher.

Efficiency improvements will also accrue to the SMR countries from harmonizing standards and measures, and regulations in areas such as subsidies, competition policy, and public procurement. Further productivity gains may result from the increased competitive pressures that will reduce monopolistic rents.

The size of welfare gains will be related to the extent to which the SMR countries implement trade reform with non-EU countries. If they do so, given the fact that the EU is already their dominant trade partner, one could anticipate that trade creation will outweigh trade diversion.

Accurate country specific estimates of costs and benefits of the EU-Med agreements depend on the variety of factors described above. Jbili and Enders (1996) provide an indicative analysis for the Tunisian case. They note that Tunisia has a large dependence on European trade and investment, tourism, and workers' remittances.[6] As of 1996, effective protection remained high in a number of sectors (e.g., textiles). Domestic industries, composed mostly of family-owned small and medium-sized enterprises, remained fragile and overly dependent on trade protection and government support.

[6] Europe has been Tunisia's main trade partner (80 percent of exports and 70 percent of imports). Furthermore, Europe provides the majority of Tunisia's tourism receipts and investment funds (both 90 percent) and is the main source of migrant workers' remittances (3-4 percent of Tunisia's GDP).

While labor costs are relatively low, the lack of adequate infrastructure, high energy costs, the shortage of industrial land, and distortions related to both remaining price controls and cumbersome administrative regulations all hinder competitiveness.

They conclude that under this agreement, Tunisia gains little additional access for its exports, except for a few agricultural items and that the expected growth of exports will result mostly from a reallocation of resources from import-substituting production into export industries, increased investment, and productivity gains. Tunisian gains would be higher if its agricultural products obtained better access to European markets during the transition period.

A number of simulations have been undertaken to estimate the impact of the Euro-Med agreements on MENA countries. They seem to indicate that generally multilateral liberalizations have slightly better welfare effects on MENA countries than adoption of a FTA. However, in the longer run FTAs may yield significant welfare gains.

Rutherford, Rustrom and Tarr (1995) provide a simulation for Tunisia's FTA with the EU. They estimate that Tunisia's welfare would increase by 3.11 percent in the short run (with sector-specific capital) and 4.65 percent in the long run (with mobile capital). By comparison, a multilateral liberalization would increase Tunisia's welfare by 3.71-5.33 percent. A second estimation by Brown, Deardorff and Stern (1997) finds that if we assume FDI and sector specific capital, Tunisia will experience a decline in welfare. Once capital mobility is allowed, welfare improves by 3.3 percent.

For Morocco, Rutherford, Rustrom and Tarr (1993) suggest that unilateral liberalization would be more welfare enhancing than an FTA with the EU, bringing about a 2.06-3.12 percent increase vs. 1.70-2.38 percent respectively. Konan and Maskus (1997) find that for Egypt, unilateral liberalization vs. formation of an FTA with EU may have the same approximate welfare effects (2.7 percent vs. 2.4 percent).

Will Martin (1997) finds that Lebanon would suffer a small welfare loss from eliminating its tariffs against the EU. A Euro-Med agreement reduces the risk of losing the access to EU markets provided under the 1977 agreement; however, the potential gains are small because Lebanon sends only 17 percent of its exports to the EU and the

margin of preference is small. Freeing trade with other SMA countries[7] would generate significant welfare gains while the barriers against the outside world remain high in these countries. Nondiscriminatory liberalization by Lebanon would be beneficial both for welfare and, by reducing the costs of exporters, for developing competitive export sectors.

Given the asymmetry of access offered by the Euro-Med agreements, the major short-term challenge faced by SMR firms derives from the increased import penetration of European products into traditionally protected manufacturing sectors. While the FTA does not require that prices in MENA countries fall to international levels (hence the small welfare gains from the liberalization outlined above) the decline to European price levels and the increased quality and variety of goods will significantly increase competitive pressures faced by a number of existing manufacturing sectors.

It is difficult to estimate precisely the impact of the relative price change that MENA firms will face at the sectoral or individual firm level. At the aggregate level, the protection from European producers could ultimately be reduced by more than 10 percent (Table 1). It will be substantially larger in specific lines of production in which tariffs and quantitative restrictions offer substantially greater nominal protection.

The simulation exercises for Egypt, Morocco and Tunisia outlined above give some indication of the sectors most likely to be affected by the Euro-Med agreements. In general, there are output gains in consumer products and light intermediates, particularly clothing. Wood products and footwear are also positively affected in the Tunisian case. Medium and heavy industries are generally projected to be negatively impacted (machinery, chemicals). Petroleum refining—and in case of Tunisia electrical machinery—seem to be the exception to this trend.

Overall agricultural output would tend to fall. In Morocco, where more disaggregated data is available, the model predicts that citrus fruits and vegetables output will grow as a consequence of the Euro-Med agreement. The general trend in services points to gains in Egypt (transport, tourism), Morocco (transport, construction) and Tunisia (financial, personal).

[7] The other countries covered by the EU's Mediterranean initiative are Algeria, Egypt, Israel, Jordan, Morocco, Palestine, Syria, and Tunisia (Nsouli, Bisat and Kanaan 1996). Turkey was also considered in the analysis because of its free trade agreement with the EU.

The transitional arrangements embedded in the Euro-Med agreements acknowledge this specter of increased competition. The protective structure applied to non-competing manufactured imports is the first to be liberalized in all cases, while the liberalization schedule applied to final goods is extended to the end of the 10-12 year implementation period. This pattern of liberalization, while providing a longer adjustment period for MENA firms, actually raises effective protection and potential profits for import competing industries during the implementation period. Unless these excess profits – and the time provided – are used to improve the competitive position of MENA firms, the resulting adjustment to increased competition may prove even more difficult than originally foreseen.

AFTA

The Arab Free Trade Area (AFTA) was established in January 1998 with eighteen member countries[8] and is to eliminate import duties and other barriers to trade on goods of Arab origin by 2008. One of the most innovative features of the program is the involvement of the private sector in monitoring the implementation of different stages of the program (including difficulties that traders encounter with customs administrations and other regulatory agencies of member countries). The implementation of the AFTA will reduce high tariffs and NTBs, increase transparency of member countries trade policies, and lead to significant trade creation (Zarrouk, 1998). The consequence will be improved intra-regional competitiveness and expanded product coverage of intra-regional exports (Devlin and Page, 2000). This process will be further stimulated by the growing intra-industry specialization in the region. There is also improved potential for attracting FDI while becoming less reliant on EU markets for exports.

The GCC

The Gulf Cooperation Council (GCC) was established in 1981.[9] The Unified Economic Agreement, ratified in 1982, specifically aimed to promote economic cooperation among its members. The Agreement's goal was to establish a common market. Following the Agreement, GCC countries removed customs duties on intra-GCC

[8] Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates and Yemen.

[9] by Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE).

imports. The adoption of a Common External Tariff (CET) has lingered and now been postponed until 2005.[10] This reduces their chances of entering into a free trade area with the EU, which had placed such a uniform tariff as a key precondition for negotiations.

There are three concerns regarding the effect of the GCC on member countries. The first is the similarity of comparative advantage among member countries and the resulting small benefits of integration. The second concern is that larger firms from more developed members will benefit from the enlarged markets, taking over the markets of smaller firms and gaining more economic (and political) power over smaller/weaker members. GCC membership also includes several potential benefits. By far, the most important of which is the effect of increased political and economic bargaining power in the world economy. As a unit, the GCC will have better access to world markets with better negotiating and bargaining power. The larger internal market allows an expansion/ diversification for local exporters to export non-oil product, achieving economies of scale, and decreasing production costs and prices to consumers. The standardization of regulations and practices will facilitate trade. The larger market may therefore attract both more intra-regional and foreign investment.

IV. Meeting The Competitive Challenge: How Is MENA Stacking Up?

In an increasingly competitive global trade environment, the timely and competitive production and delivery of goods is of critical importance. Trade logistics can enhance or hamper the competitiveness of producers and exporters. In this regard, institutional facilities and services, and trade-related infrastructure become necessary but not sufficient for global success

Customs Administration and Reform

Most MENA countries have undertaken tariff and tax reforms since the 1980s but progress has been slow and uneven. Egypt, Jordan, Morocco and Tunisia have made the most progress. Nevertheless, tax and tariff systems in MENA are complex and difficult

[10] The measure to postpone implementing a common tariff to 2005 was mainly brought about by the UAE. The UAE has a broad customs rate of 4% and would therefore be forced to increase customs duties, negatively affecting the country's re-export trade, if the agreement was implemented. Currently, Qatar, Kuwait and the UAE impose a rate of 4%, Bahrain a 5-20% rate, Saudi Arabia 12% and Oman 5-15% although some products are zero-rated. In Saudi Arabia and Kuwait, rates can be as high as 30%.

to administer. Most countries are still using non-tariff barriers such as quantitative restrictions and surcharges.[11] Furthermore, while effective tariffs are not excessively high compared to the average of non-OECD countries[12], their variance adds to their discriminatory effects.

Reform of border measures, however, does not address fully the institutional reform needed for effective trade integration. Table 8 provides insight into the work still needed in this area. Importing firms find customs procedures (inspection, valuation and quality control) very binding. This in turn affects costs and competitiveness of domestic producers and exporters. MENA countries need to rationalize their imports and export procedures to reduce traders' uncertainty, costs and delivery time (see Appendix B).

Many Asian and Latin American countries have made great progress in implementing procedures that require filing one form and minimize the time spent going through customs. El Salvador's reform efforts illustrate one successful approach. It established the Center for Export Requirements (CENTREX) in 1987 to centralize all permit requirements for imports and exports. Before CENTREX, the preparation of documents took from 8-10 days, sometimes 15 days. In 1995, CENTREX established the Electronic System for Exports (SIEX) to speed-up export formalities. This has allowed companies to obtain automatic export permits on-line seven days a week. Sanitary certificates, certificates of origin, and other documentation are processed the same day. The introduction of SIEX has reduced the time for preparation of export documentation to less than one day.[13]

Governance Issues

Transparency, impartiality and predictability of rules in taxation, ownership, labor, and investment provide a business friendly environment by reducing the potential for discretionary actions and corruption. Table 7 provides information on how the MENA countries rate in three governance aspects. In all three categories (law, corruption, and

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[11] Algeria and Egypt are at the more liberal end and Syria and Morocco are at the most restrictive end.

[12] The effective tariff for MENA countries range from 9.93 (Syria) to 19.62 percent (Tunisia) while the average for non-OECD countries is 13.5%. That of Asian non-OECDs, 13.45%, African countries, 16.98%, Middle Eastern countries 11.39% and Western Hemisphere nations 10.91%. Data obtained from Abed (1998), table 3, pg. 15.

[13] Sam Laird "WTO Rules and Good Practices in Export Policy." WTO Staff Working Paper, March 1997.

quality of bureaucracy), the MENA region compares favorably to East Asia and Pacific as well as Latin American Countries.

Table 7. Binding Constraints for Firms

Importing Firms	**Score**	**Ranking**
Customs procedures (inspection, valuation and quality control)	0.85	1
Port Services (formalities, discharging, handling, storage and high fees)	0.75	2
Freight Transportation Regulation (road and maritime)	0.596	3
Import Policy Uncertainty	0.54	4
Exporting Firms		
Competition Rules in Importing Countries (anti-dumping actions)	0.95	1
Standards and Quality Control Requirements (in importing countries)	0.72	2
Freight, Insurance, Export Financing Services	0.64	3
Customs Procedures (in importing countries)	0.52	4

Note: Traders were asked in the questionnaire to rank the severity of a set of obstacles on a scale of 1 to 5. The score results were normalized to a scale of zero to 1 where zero means that the constraint is not binding at all and 1 means that the constraint is prohibitive. Regulatory constraints with a score equal or greater than 0.5 were retained in the final results.
Source: Jamel Zarrouk, "Regulatory Regimes and Trade Costs."

On an individual basis, however, all MENA countries ranked a marginal two on the quality of bureaucracy index, below S. Korea and Malaysia's. Egypt and Algeria rank poor (2 out of 6) on the corruption ranking while the others rank average to above average (3 or 4 out of 6). These two constraints are identified in surveys as a source of great concern for producers and exporters (Zarrouk, 1998). The costs of corruption and the uncertainty correlated with opaque bureaucratic processes reduce profitability and incentives for expansion of production and exports.

Trade-Related Infrastructure

Development of physical infrastructure to reduce the costs of doing business and foster trade is key to a competitive productive chain and arms-length delivery. This infrastructure base includes roads, ports, airports, corresponding handling (loading and unloading) and storage facilities, electricity, water and telecommunication.

The MENA countries still face a panoply of infrastructural constraints. Table 8 highlights this fact by comparing MENA's infrastructure (telephone lines per 1000 people, electrical power production and roads) with fast integrators such as South Korea,

Malaysia and Argentina. Importers rank port services (formalities, discharging, handling, storage, high fees) and freight transportation regulations (road and maritime) as serious constraints. Exporters consider freight issues a barrier to trade.

Table 8. ICRG Indices for Bureaucratic Quality, Corruption, and Law and Order, 1998

Countries & Regions	Quality of Bureaucracy[1]	Corruption[2]	Law and Order[2]
Morocco	2	3	6
Tunisia	2	3	5
Egypt	2	2	2
Algeria	2	2	4
Jordan	2	4	4
Bolivia	2	3	3
Costa Rica	2	5	4
Korea	3	4	4
Malaysia	3	3	5
EAP	2	3	4
LAC	2	3	3
MENA	2	3	4
SA	2	3	3

Notes: [1] For bureaucratic quality, the index runs from 0 (bad) to 4 (good).
[2] The corruption and law and order indices run from 0 (bad) to 6 (good).
Source: SIMA database, LDB Central.

Malaysia's approach to improving trade facilitation has involved the private sector in managing port facilities since the mid-1980s at Port Kelang (leasing containers to private consortia). Starting in the early 1990s, Malaysia expanded this approach to cover more local ports and maritime transport related services. In each port productivity has increased between 15 and 20 percent. The Philippines also had a very successful experience with reform in this area. In 1988 the government contracted with the private sector for the operation of the Manila International Container Terminal (MICT). The impact was immediately felt: ship turnaround time was reduced by 60 percent. The increase in productivity was between 15-20 percent.

Tables C1 – C3 in Appendix C provide further information on telecommunication and computers. While local businesses rate telephone services as fair to good, the wait for a new telephone line is on average over a month and in several cases over a year (Table 12). Furthermore, telephone mainlines and personal computers available in the group of MENA countries are much lower than in their East Asian counterparts.

Clearly communications facilities need further, rapid enhancement. Privatization and private sector involvement has been successful in alleviating this constraint in Latin America (LAC) and East Asia. LAC has been leading all regions in private participation in this sector. Total investment in telecommunications projects with private participation in LAC from 1990-98 was about $110 billion followed by EAP at about $40 billion, while MENA has a meager $2-$3 billion. The Philippines has the most liberalized and privatized telecommunications market among Asian economies. In reforming this sector, the Philippines followed the common Asian approach: a shift from public to private ownership, increased scope for foreign ownership (and/or control) and liberalization of entry into the industry. The number of main lines grew 21.3 percent per year from 1990-1995.

V. What Needs to be Done?: Private and Public Action

A post-Seattle round of the WTO may increase both export opportunities and domestic competition. The EU-Mediterranean agreements will also soon bring European competitors into Arab domestic markets. Are Arab producers ready to compete with them? Seeking further protection only delays the inevitable. Investing in improving productivity, in new products and market analysis by business associations and individual exporters will become progressively more important for MENA firms.

Standardization of Products

Producers and exporters can add a great deal of qualitative information and credibility to their products by using internationally accepted certification methodologies. By ensuring that they match these standards they minimize importers' uncertainty regarding product quality. For instance, in the Kaohsiung Export Processing Zone (Taiwan, China) many of the firms and their domestic suppliers are voluntarily adopting ISO 9000 certification to ensure buyers of the quality of products.

Seeking New Product Lines

Services outsourcing decisions are based on four factors: adequate labor skills, common language, lower labor costs, and the technological and communications network necessary to allow timely processing of documents. In MENA, and more specifically in countries such as Tunisia, the first two factors are fulfilled. Improvement of communications network will open up the field to rapid expansion of services exports.

As discussed previously, better market access for agricultural products both to the EU and other developing countries markets will allow MENA countries to develop and reap the benefits of their comparative advantage in fruits and vegetables. In this light, their active participation in international negotiations (such as the WTO) is critical.

Seeking New Markets

Since the EU is the main trade partner of most Arab countries, Arab exporters are directly affected by the EU economic conditions. Exporters should seek to spread their business risks by diversifying their buyers. MENA countries have very little import penetration in East Asia and Latin America, not to mention the rest of Africa. Intra-regional trade may offer opportunities for MENA exporters.

Trade Facilitation

Implementation of trade facilitation measures in MENA economies should be accelerated. One such activity is a recent project, being launched in Tunisia with the assistance of the World Bank that aims at unifying and computerizing export requirements: TUNI-NET.

The examples of the Philippines and Malaysia discussed in this paper provide good examples of productivity gains and cost reductions arising mainly from transportation facilitation, end of monopolies and privatization. We provided striking examples of improvements in telecommunications in East Asia. Many MENA countries are still very cautious in undertaking reforms in this area (Algeria, Tunisia, Syria). Morocco started this process with the August 1999 award of a second mobile telecommunications license through an international tender. All bidders had made commitments on quality, coverage and tariffs that would significantly expand and improve services. The winning bid went to Medi-Telecom, a consortium of Telefonica of Spain, Portugal Telecom and Moroccan Investors. The new license has already prompted the existing service provider to improve services and reduce prices.[14]

Minimization of red-tape, discretionary rules and regulations for exports remains a top priority. The administrative set up of export processing zones is a good example of a hands-off regulatory regime. MENA governments have not used free trade zones to the same extent as Latin American and East Asian governments as devices to streamline institutional and infrastructure services to exporters. Mexico, the Dominican Republic,

[14] Bjorn Wellenius and Carlo Maria Rossotto. November 1999. " Public Policy for the Private Sector". Note no. 199. The World Bank Group. Finance, private sector and infrastructure network.

and Malaysia are notable for the variety of quasi free trade environments established – from duty free zones, to export processing zones, to bonded warehouses, to duty free factory sites – to facilitate export transactions. Recent reforms of public sector free zones in Egypt, Jordan, Saudi Arabia and Yemen point in the right direction but implementation of the institutional and regulatory changes will be the key to success. There are very few examples of successful private development of export processing zones in the region.

Industrial Restructuring

The Euro-Med Agreements include very substantial resources for industrial sector adjustment to the increased competitive challenge of European imports. Egypt and Tunisia have begun to implement industrial restructuring programs, designed to assist firms to upgrade technology, improve product quality, and diversify product lines. These programs are based public-private partnerships and often include access to investment capital at subsidized interest rates for "approved" restructuring plans.

The existing programs in Tunisia and Egypt have met with some skepticism on the part of firms. Latin American governments including Mexico, Colombia and Argentina pursued similar restructuring programs in the late 1980s and early 1990s during their trade liberalizations (See Appendix D). In general, those programs were most successful when they exhibited a number of common attributes:

- An organized public-private partnership along specific sectoral lines that defines the nature of the restructuring program and the approach to be followed.
- A restructuring program focused on providing information as a public good to all firms in the sector on the types of changes that would be needed to meet increased competition.
- Financial institutions are brought into the process at an early stage so they understand the "bankability" of proposed projects. Interest rates were not subsidized and investment decisions were left to the market.
- Substantial effort is given to learning and follow-up.

Although the MENA region's restructuring programs are still in their infancy, there is some question whether they currently exhibit all of these characteristics.

VI. Conclusion

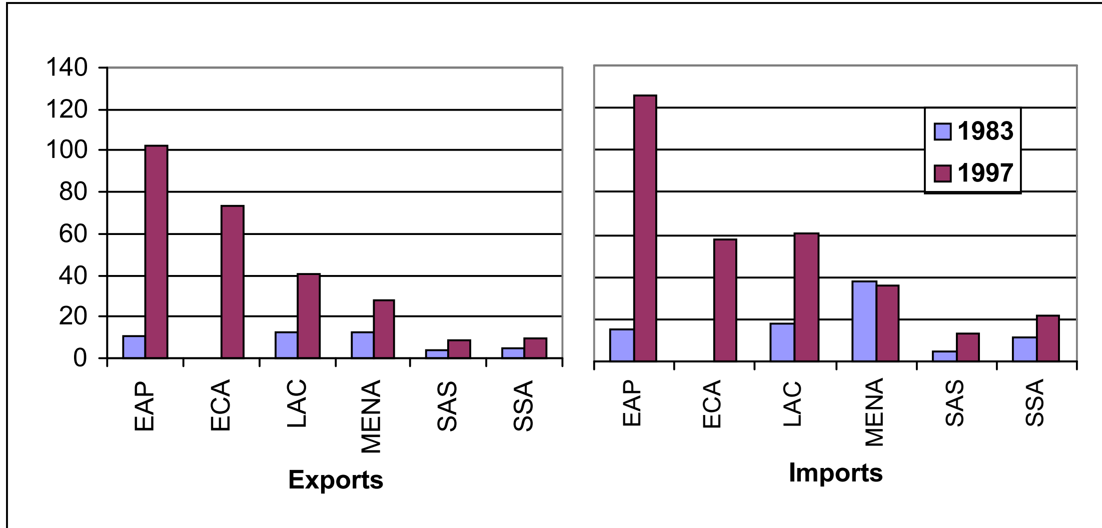
The changing global environment for trade offers both challenges and opportunities for MENA firms. Rapid progress on the multilateral agenda appears unlikely in the post-Seattle confusion surrounding the WTO, but the competitive challenge of trade to MENA firms remains substantial. Regional agreements will offer both increased export opportunities and the prospect of greater import penetration.

There are a number of areas in which firms can help to prepare themselves to meet this competitive challenge. First, they can call on governments to accelerate efforts to improve the institutions governing trade and investment and trade-related infrastructure. Second they can resist the temptation to use the transition periods allowed in regional agreements to continue business as usual. Effective industrial restructuring will require changes in products, standards, and business lines. These are better made sooner than later.

Governments in MENA can become more effective partners of the private sector, both by giving firms clear signals about the nature and magnitude of changes that are going to occur as a result of changing global and regional rules and by making the complementary institutional changes needed to implement the rules effectively and fairly. Opening trade-related infrastructure to public-private partnerships or wholly private investment is also a critical priority.

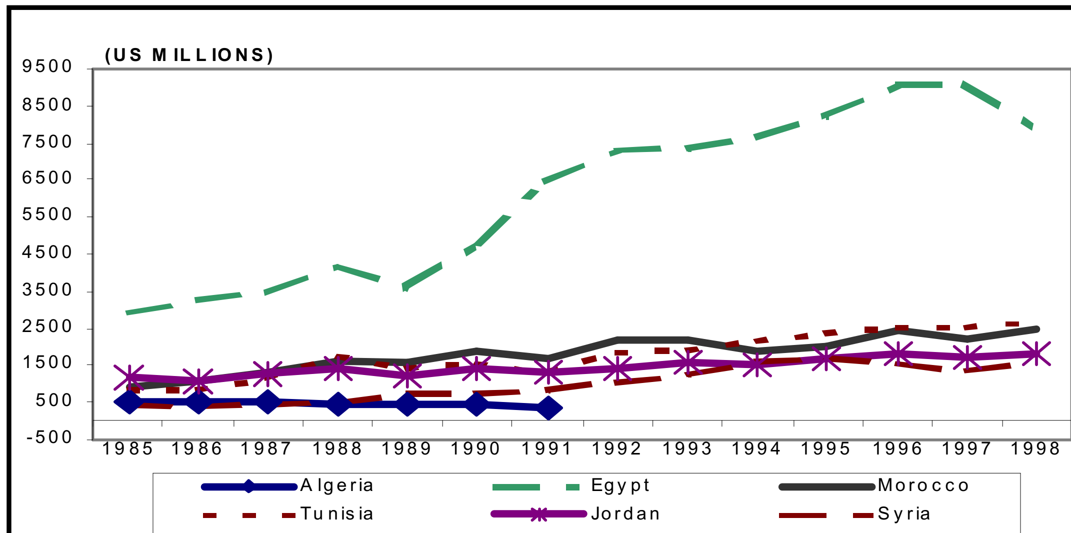
Appendix A
Regional Trends in Import and Export

Figure A1. Exports and Imports of Commercial Services



Source: WDI, 1999.

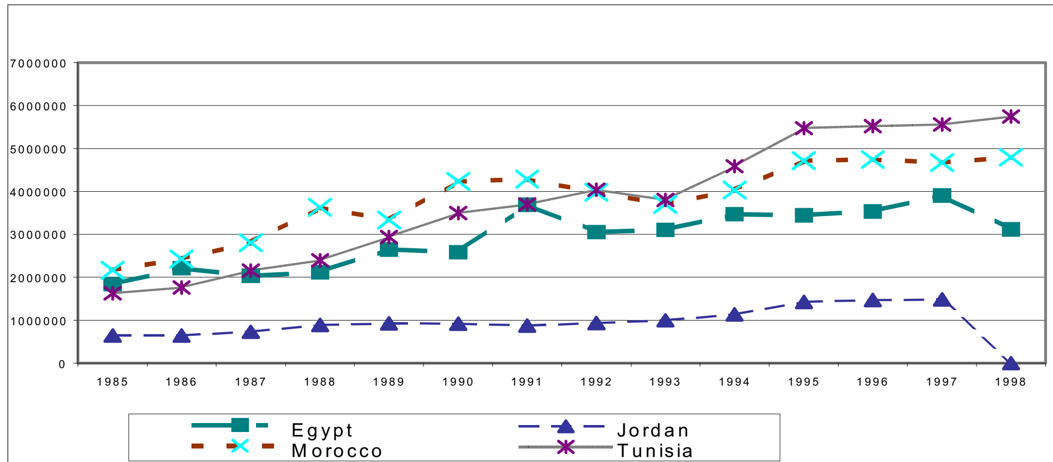
Figure A2.Commercial Service Exports for Selected MENA Countries



Note: Commercial services include transport, travel, and other commercial services.
Source: WTO.

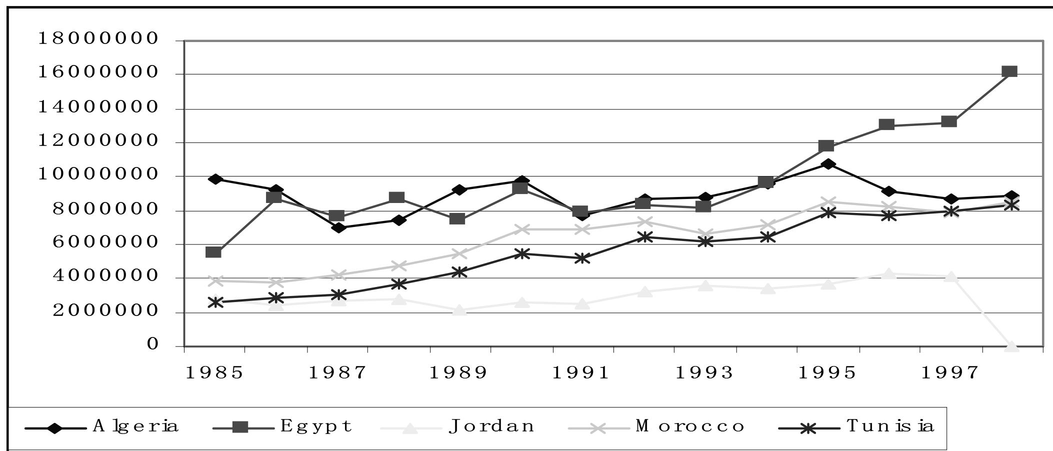
Appendix A. Regional Trends in Import and Export (Continued)

Figure A3. Trends in Exports of Goods for Select MENA Countries (US$ billion, 1985–1998)



Source: World Integrated Trade Solution (WITS), Trade Data Warehouse, UN Comtrade

Figure A4. Trends in Imports of Goods for Select MENA Countries (US$ million, 1985–1998)



Source: World Integrated Trade Solution (WITS), Trade Data Warehouse, UN Comtrade

Appendix B
Registration, Documentation and Customs Procedures

Registration, Documentation and Customs Procedures in Jordan

Registration, documentation and customs procedures have undergone simplification in Jordan. The introduction of computerization and decentralization have streamlined the process of importing goods. Furthermore, import licensing requirements have been completely abolished except for those products that have a national security, health, safety, environment or religious risk. Yet, even with these changes customs procedures remain cumbersome and time-consuming. Even traders feel that the situation has become worse despite the reforms that have taken place.

Importing firms are required annually to register for an import card which are required for good that do not need an import license. Without an import card a fine of five percent of the value of a good is added to the cost of clearance. All goods must be accompanied by a customs declaration form, original copies of the commercial invoice and the classification of the good according to the customs tariff in Arabic. The invoice and the certificate of origin must be certified by the Chamber of Commerce and the Jordanian diplomatic mission in the product's country of origin. In the event that the necessary documentation is not submitted, the customs authority will impose a cash guarantee of one percent of the good's value. Refunds are available if the necessary documentation is presented within 60 days of payment of the guarantee.

Valuation of a good is based on comments coming from the inspecting officer, invoice and product price list complied by the Customs Department. The Jordanian Customs Department has yet to apply the Brussels definition of value of the GATT valuation code. Both the Customs Department and the importer can dispute the value of a commodity based upon the declaration form. Importers must submit a claim to the Director of the Customs Center and then to the Director General at customs headquarter if they are still not satisfied. Goods cannot be cleared until the dispute is settled.

Source: Riad al Khouri, "Trade Policies in Jordan, Lebanon, and Saudi Arabia."

Registration, Documentation and Customs Procedures in Lebanon

Registration, documentation and customs procedure have undergone streamlining and simplification through the introduction of computerization in Lebanon. A major rehabilitation program has been launched to modernize customs procedures. These new procedures make importing a good much easier. It now only takes three or four steps and four to five days for goods to be released from customs. The procedures have been implemented at the Port of Beirut and the Beirut International Airport which covers about 85 percent of customs volume. Many goods, about 41 percent, go through customs without being inspected at all. The reforms have reduced the discretion of officials but nevertheless poor incentive schemes for employees and weak oversight measures have continues to result in corrupt behavior.

Importers are assigned to a Verificateur and a Chief Inspector to inspect the goods and assign appropriate tariffs. Problems arise from this system due to the fact that the importer lacks the ability to request another Verificateur or Chief Inspector in the case of a dispute. If there is a dispute the importer can use an expert to assess the value of a good. This is very often avoided by the importer due to the fact that the expert is often a competitor and can request a large fee for assessing the good, delay the release of the good or increase the value of the good, resulting in higher tariffs for the importer. This systems gives the Verificateur and Chief Inspector enormous amounts of power over the importer and makes the customs procedures in Lebanon highly prone to corruption.

Source: Riad al Khouri, "Trade Policies in Jordan, Lebanon, and Saudi Arabia."

Appendix C
Indicators: Telephone and Computer Infrastructure

Table C1. Infrastructure Indicators for Select Fast Integrator and MENA Countries

	Telephone Mainlines (per 1,000 people), 1996	Paved Roads (%), 1996	Electric Power Production (kilowatt hours per person), 1996
Fast Integrators			
Argentina	174	29	1993
Chile	156	14	2199
Korea, Rep.	430	73	4849
Malaysia	178	75	2447
Mexico	93	37	1747
Morocco	46	50	457
Thailand	70	98	1457
Average	*161*	*52*	*2306*
MENA			
Iran	95	50	1514
Syria	80	23	1133
Tunisia	64	79	837
Egypt	50	78	975
Jordan	62	100	1514
Algeria	44		712

Source: SIMA Database, WDI & GDF Central.

Table C2. Main Indicators for Telecommunications Services in MENA Countries, 1999

	Waiting Time for Installation of direct line	Cheap Call Tariffs ($/min). & Time of Day	Local Business Evaluation of Telephone Services	Internet Availability	Annual Subscription Fees ($)	User's Fees ($)	Party Offering Internet Services
Algeria	1 yr +	9pm-5am	Fair	Yes	-	172/mth	Govt.
Egypt	1 yr +	9pm-6am	Good	Yes	260	Open	Private
Jordan	1 mth	10pm-7am	Good	Yes	-	20/mth	Private
Lebanon	1 mth	None	Good	Yes	1000	45/mth	Private
Morocco	1 mth +	8pm-7am	Fair	Yes	750	Open	Private
Qatar	1 wk	8pm-7am (0.28)	Good	Yes	55*	17/mth	Govt.
Syria	2 yrs +	10pm-3am	Fair	No	-	-	-
Tunisia	1 mth +	8pm-6am (1.6)	Fair	Yes	600	Open	Private
Yemen	1 yr +	None	Fair	Yes	335	0.10/min	Govt.

Note: * Registration Charge
Source: Partial reproduction from tables in Jamel Zarrouk, "Regulatory Regime s and Trade Costs."

Appendix C. Indicators: Telephone and Computer Infrastructure (Continued)

Table C3. Information Infrastructure in Select MENA Countries and Others

Country/Region	Tel. Mainlines		Wait (in years)	Personal Computers		Paved Roads (%)		Paved Roads in Good Condition (%)
	1990	*1997*	*1997*	*1990*	*1997*	*1990*	*1996*	*1994*
Algeria	32	48	8	1	4	67	69	40
Tunisia	38	70	1	3	9	76	79	40
Morocco	16	50	0		3	49	50	50
Egypt	30	56	4		7	72	78	43
Jordan	58	70	5		9	100	100	72
Syria	40	88	10		2		23	
Taiwan	310	500	0	34	118	85	89	
Korea	310	444	0			72	73	
Malaysia	89	195	0	8	46	70	75	
EAP	16	60	1	2	11	24	12	
ECA	125	189	3			77	83	
LAC	64	110	1	6	32	22	26	
MENA	37	71	5		10	67	50	
SA	6	18	6	0	2	38	41	
SSA	10	16	4		7	17	16	

Note: Telephone mainlines (per 1,000 people), Personal computers (per 1,000 people), and wait refers to time in years to get a telephone mainline.
Source: SIMA Database, WDI & GDF, World Road Statistics and MNA LDB.

Appendix D
Industrial Restructuring

Mexico Industrial Restructuring

Following the 1982 debt crisis, Mexico began a process of economic reform, under the De La Madrid administration (1983-1987), which included macro reforms such as liberalization and stabilization and structural reform—de-regulation, industrial restructuring and eventually privatization.. Rapid trade liberalization including Mexico's entry to the GATT, the dismantling of most non-tariff barriers and a deep reduction, across the board, in tariff levels was designed to open the Mexican economy to competition in world markets. This process culminated with Mexico's adherence to NAFTA.

Structural reforms, under De La Madrid, were initially focused on industrial restructuring and complementar de-regulation. Eventually, during the Salinas administration (1988-1993) privatization became the focus of structural reform. Industrial restructuring was essentially bifurcated between restructuring and eventual privatization of state owned enterprises (SOEs) and support for private sector restructuring, in the wake of market failure during the debt crisis. .

Industrial restructuring support for the private sector consisted primarily of de-regulation and a substantial effort by the Government to assist sectors that needed to adjust in the wake of liberalization. With respect to de-regulation, at the beginning of each administration, Sexeino (six year term), the Government traditionally prepared plans for each industrial sub-sector, supported by a comprehensive system of licensing for firms seeking to enter the sector. There was also strong control over direct foreign investment, generally restricting majority foreign ownership. Therefore, many large domestic groups, with close ties to the Government, generated profits through rent seeking activities, for example, exclusive licenses to enter particular market niches or through large government contracts to provide goods and services to the SOEs. Not surprisingly, pervasive corruption further distorted the market. Starting in 1986 the Government began to dismantle its central planning system and to de-regulate. In addition, the Government began to promote direct foreign investment (DFI) and lift ownership and other adverse restrictions on DFI in all, but a few strategic sectors, primarily oil and gas and electricity.

For example, in the automobile industry, the Government revamped a series of regulations governing the autoparts sector that eliminated a domestic "must buy" list, reduced domestic content regulations, and generally reduced a host of restrictive regulations. In its place, the Government created a number of incentives supporting exports of both autoparts and assembled vehicles. In just a few years, the Government was able to induce some $ 10 billion of DFI into the sector as U.S. auto makers fearing Japanese competition began to assemble cars for export from Mexico into the U.S. This was followed by investments from foreign auto producers, and a critical cluster of activity was created in the sector. Similar de-regulation occurred in electronics, attracting major producers such as IBM and Hewlitt Packard who eventually exported a majority of their production from Mexico, and in pharmaceuticals where price control had prevented investment in the sector.

For largely traditional industries, with high domestic employment, such as textiles and garments, leather goods, auto parts, wood furniture and agro-industry the Government assisted a partnership of industry and banks through support for a series of sub-sector analysis by leading strategic consulting firms. These analysis identified major impediments to competitiveness in each of the sub-sectors, benchmarked Mexican industry versus world class competitors, and also identified policy, regulatory and infrastructure constraints common to the industrial sector as a whole. Therefore, the efforts to de-regulate were tied closely to the work on industrial strategy.

Subsequent port reforms, port privatization and modernization emerged from physical constraints to exports identified by these studies. The key to the program was the involvement of Mexican industry in dialogue with the Government and with representatives of the financial sector through a number of working groups, coordinated via a steering committee of leading industrial and government representatives. Also an inter-ministerial committee was established to support required policy and regulatory changes high lighted by the studies and endorsed by the working groups. The World Bank assisted in this effort through substantial advisory support and an Industrial Restructuring loan, that was a hybrid supporting policy de-regulation and investments by firms undertaking restructuring efforts.

Source: Ira W. Lieberman

Appendix D. Industrial Restructuring (Continued)

Best Practice Industrial Restructuring,
The Case of Colombia

In February 1990, the Government of Colombia initiated a program with three main goals: liberalize the external trade regime, accelerate reform of public services and develop an internationally competitive private sector. The World Bank's Industrial Restructuring and Development Project (IRDP) was part of a package of policy and institutional adjustments to facilitate the Government's program. Various initiatives were used to achieve the Government's goals:

- International Competitiveness: renovation, expansion and/or reduction of industrial production capacity; facilitate reorganization and liquidation in bankruptcy procedures
- Trade Liberalization: Targets for reductions in quantitative restrictions on imports and tariff rates. The average import-weighted tariff was fixed at 11.5 percent and tariff categories were reduced from 23 to 5.
- Labor Regime: revised labor legislation for increased labor mobility, Labor Adjustment Assistance Program (PAL) to assist those who are displaced as a result of industrial restructuring.
- Financial Sector: reduced forced investments and interest rate subsidies

In total, overall industrial production grew by an average of 3.9 percent during 1992-1995, productivity grew by an average of 4.1 percent while labor costs grew at 3.4 percent. Sixty[1] percent of enterprises reported an increase in their productive capacity, and a similar share experienced and increase in labor productivity. Seventy[1] percent of firms viewed the labor policy reforms as having a positive influence on the economy. The PAL program, undertaken by 83 different firms involving 16,000 workers, helped to improve productivity and product quality. Finally, interest rates were raised on industrial direct credit and the Government eliminated the use of direct credit schemes altogether. The success of the restructuring is largely attributed to the Government commitment and strong management of macroeconomic policy.

Note: [1] Based upon a survey of firms who were active in the reform programs.

Source: Implementation Completion Report, "Colombia Industrial Restructuring and Development Project (Loan No. 3321-CO)." World Bank, Nov. 1998.

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