Trade, Foreign Investment and Development in the Middle East and North Africa

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MENA’s Development Challenge: Slow Growth and Rising Unemployment

During 1980-2000,
- Per capita growth averaged only 0%,
- Unemployment rose to over 14%,
- Non-oil exports stagnated at 7% of GDP, and
- Foreign investment stayed under 0.5% of (PPP) GDP

These trends are linked: higher trade and investment is needed for higher growth and employment
Growth rates have been low….
Unemployment has risen...

Unemployment rates are rising rapidly in MENA, 1980-2000

MENA refers to data where available for 12 countries: Algeria, Egypt, Iran, Jordan, Lebanon, Morocco, Syria, Tunisia, Yemen, Oman, Bahrain, and Saudi Arabia.
Poverty, while comparatively low, has risen slightly during 1990-2000.
And exports have stagnated...

**Exports (as percent of GDP)**
Middle East and North Africa (all countries)

<table>
<thead>
<tr>
<th>Year</th>
<th>Non-oil Exports</th>
<th>Total Merchandise Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>7.0</td>
<td>47.0</td>
</tr>
<tr>
<td>1990</td>
<td>6.5</td>
<td>27.0</td>
</tr>
<tr>
<td>1995</td>
<td>6.2</td>
<td>22.0</td>
</tr>
<tr>
<td>2001</td>
<td>6.0</td>
<td>19.0</td>
</tr>
</tbody>
</table>
Overall trade patterns have been similar despite diversity among MENA countries

Source: Staff estimates.
Needed: A new engine of growth based on trade and private investment

- The experience of the last two decades suggests that the old model, driven by the public sector and supported by oil, aid and remittances, is failing. A new model, based on trade and private investment, is needed.

- MENA has a huge potential for expanding trade. Exports are one-third of potential. Foreign direct investment could be five times larger than it is.

- If only one-half of trade and FDI potential were realized, this would be sufficient to raise GDP per capita growth to 4% per annum from the present level of 1% or so. This could generate 4 million additional jobs over the next five years.
Countries that trade more grow faster

Increase in Trade/GDP: 1970s to 1990s

Fast-integrating countries grow faster, 1990s

Source: Dollar (2002)
Trade and industrial jobs go hand-in-hand: Morocco earlier and Mexico post-NAFTA

Employment in manufacturing and manufacturing exports/GDP

Exports in manufacturing (% of GDP) (Right axis)

Employment in manufacturing (% of Working age population) (Left axis)

Source: Employment data are from Unido. Manufacturing exports are from WITS-UN. Working age population data are from WDI World Bank.

Persons (OOO)  Millions Constant pesos (1995)

Exports of goods (right axis)

Employment (left axis)
MENA under-trades: non-oil exports are below the potential based on per capita incomes, natural resources and population

Actual to predicted non-oil merchandise exports, per capita

PCNOXs = -134.3 + 0.19*GDPPPPPC - 0.54*PCNatRes - 74.7*Log(Pop)
Adj R2=0.60  Sample Size 42

High-performing countries

Under-performing countries

02/23/2006

World Bank, MENA region
MENA under-trades: non-oil exports ($34 billion) are far below those of other country groupings of similar size.

ECA-5: Czech Republic, Hungary, Poland, Russia, Turkey; EASIA-3: Indonesia, Malaysia, Thailand; LAC-4: Bolivia, Chile, Mexico and Brazil; MENA10: Algeria, Egypt, Iran, Jordan, Lebanon, Morocco, Syria, Tunisia, Yemen and Saudi Arabia.
Foreign investment is negligible compared to flows going to other regions.
Foreign direct investment is below potential based on openness, natural resources and population

\[
\text{FDIPC} = 76 + 0.07^\text{NOXPC} + 0.04^\text{NRXPC} - 10.9^\text{LOG(POP)} \\
\text{Adj R}^2 = 0.27; \text{Sample Size 42}
\]

Source: World Development Indicators.
Note: Regression is based on 42 countries; values for 2 low-income countries (Indonesia and Yemen) are not reported because of negative values.
MENA in the global production chain: parts and components production is a small fraction of manufactured exports
Impediments to greater trade and investment:

- Some non-economic constraints are important: for example, internal and external conflict.
- But domestic policies are important as well.
- These include: standard trade policies and sound management of the exchange rate.
- But the key lesson that is emerging is that trade and investment outcomes are critically determined by investment climate considerations.
MENA has experienced a relatively high frequency of violent conflicts

Frequency of Conflict across Regions, 1945-99

Number of Conflicts

Note: Data available by conflict were mapped to standard World Bank regional classification. EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa. For definition of violent and nonviolent conflicts refer to http://www/hiik.de/en/index_e.htm.
Tariff and non-tariff barriers: MENA is higher than many competitors
Exchange rate policies have constrained competitiveness

Mis-alignment in MENA was 22% in 1985-99, compared to 10% for LAC, and 5% for East Asia
Investment climate considerations

It is critical to go beyond trade reforms to improving the investment climate because:
- employment gains come largely when export oriented investment increases
- investment and exports are higher when
  (a) the quality of services (e.g., transport, finance, power, telecommunications) is better, and
  (b) transactions costs (for customs, freight, business registration etc.) are lower
Industrial employment and exports relationship in countries with high foreign direct investment

Employment in industry after controlling for factors other than non-oil merchandise exports (as a ratio of total working-age population; in logarithm)

Non-oil merchandise exports; in per cent of GDP

Developing countries
Large FDI recipients

$R^2 = 0.4639$
Industrial employment and exports relationship in countries with low foreign direct investment

Employment in industry after controlling for factors other than non-oil merchandise exports (as a ratio of total working-age population; in logarithm)

Developing countries
Low FDI recipients

$R^2 = 0.0044$
Where MENA stands in services liberalization

Telecommunications

Liberalisation index (average for each country group)
Where MENA stands in services reforms: Power sector

Regulatory reform indicator as of 1998 (maximum score - 6)

Source: World Bank staff.
Selected transactions costs:
Business registration costs

Costs of Entry

Percent of GDP per capita

MENA EAP5 ECA4 LAC4

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MENA can raise its per capita growth to nearly 4% per annum with higher trade, investment and productivity

Potential for faster GDP growth, accumulation and productivity from trade and investment climate reforms in MENA, 2003–13 (percentage per annum per worker, except when noted)

<table>
<thead>
<tr>
<th>Region</th>
<th>Physical Capital</th>
<th>Human capital</th>
<th>Total factor productivity</th>
<th>Growth of GDP per labor (labor force weighted)</th>
<th>Growth of GDP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>MENA</td>
<td>-0.3 2.4</td>
<td>1.2 1.2</td>
<td>-0.2 1.4</td>
<td>0.7 3.0</td>
<td>1.4 4.3</td>
</tr>
<tr>
<td>EAST ASIA</td>
<td>8.4 0.7</td>
<td>3.2</td>
<td>7.0 7.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOUTH ASIA</td>
<td>3.3 0.9</td>
<td>0.9 2.7</td>
<td>3.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>OECD</td>
<td>2.0 0.6</td>
<td>0.4 1.6</td>
<td>2.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>WORLD</td>
<td>4.8 0.7</td>
<td>1.6 3.9</td>
<td>4.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Staff Estimates
Note: All growth estimates by regions and world are labor force weighted.
1. GDP per-capita growth rates differ from GDP per labor growth rates because of differences between labor force and population growth rates.
2. “..” means not projected.