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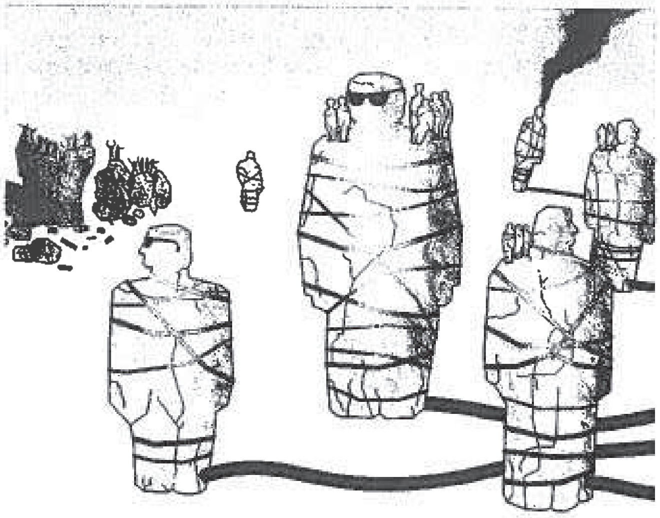
Why trade reform matters in the Middle East



A YEAR after the start of the Arab spring, no government in the Middle East has attempted serious economic reform even though it is obvious both that economies are distorted and that discontent over living standards has played a big part in the uprisings. The main reaction by governments has been to buy off further protests by increasing public spending. Saudi Arabia boosted government spending by over 50% between 2008 and 2011.

Although higher oil prices have been enough to finance these rises, much of the extra spending has gone into public-sector wages and consumer subsidies. Food and fuel subsidies are often huge: over 10% of GDP in Egypt. In the region as a whole, fuel subsidies rose from 2.3% of GDP in 2009 to 3.2% in 2011.

These subsidies benefit the rich, keep loss-making firms alive and damage the economy. According to the IMF, the richest fifth of Jordanians capture 40% of fuel-subsidy gains; the poorest fifth get 7%. More important, subsidies exacerbate the region's most important economic problem, which, argue Adeel Malik of the Oxford Centre for Islamic Studies and Bassem Awadallah*, a former Jordanian finance minister, is "that it has been unable to develop a private sector that is independent, competitive and integrated with global markets". By distorting domestic prices, subsidising energy-guzzling firms and increasing public-sector wages relative to private-sector ones, the past year's actions have made it even harder to develop a flourishing private sector.

It was hard enough before. The Middle East has strikingly few private companies, less than one-third of the number per person in eastern Europe. Everywhere the state dominates the economy. In Egypt the public sector accounts for 40% of value-added outside agriculture—an unusually large share for a middle-income country. Such private firms as do exist tend to be large and closely connected to the state. The average Middle Eastern company is ten years older than in East Asia or eastern Europe because new entrants are kept out by pervasive red tape. The authors reckon it costs roughly 20 times the average annual income to start a firm in Syria and Yemen (assuming anyone would want to), just over twice the average globally. In a few Arab countries, like Tunisia, some notorious personifications of crony capitalism have fallen foul of political change but the practice has by no means ended.

The weakness of the private sector is typically seen as a domestic problem with domestic solutions, notably privatisation and deregulation. Earlier attempts to strengthen private businesses by pursuing those policies were in practice half-hearted or skewed towards well-connected insiders, tainting the whole process of reform. The risk of the same outcome is a big reason why, in the aftermath of the Arab spring, risk-averse governments have shied away from further efforts to privatise or cut red tape. But, argue Messrs Malik and Awadallah, there is also a regional aspect to the private sector's weakness—the failure to develop regional markets. Here, reform may be politically easier.

Arab companies are globally uncompetitive. The Middle East accounts for less than 1% of world non-fuel exports, compared with 4% from Latin America (a region with a comparable population). Turkey exports five times as much as Egypt, which has a population of similar size. Despite its favourable geographical location the Middle East is rarely part of global supply chains. And of its modest global exports, inter-Arab trade accounts for less than a tenth, barely more than in 1960.

The usual explanation for the failure to trade is the region's resource curse. Because it is so easy to export crude oil, Arab countries have failed to develop significant merchandise exports. And because so many export the same thing—oil—they naturally do not trade with each other. Even if that were the whole story, the region would still need to develop competitive manufacturing or services to cope with demographic change. Oil cannot generate the tens of millions of new jobs that predominantly young Arab countries will need. But it is not the whole story. Arab countries could trade with each other more than they do, and part of the reason that they do not is self-inflicted.

Obstacles to regional trade are legion. Costly "trade logistics"—non-tariff barriers, red tape and poor infrastructure—add 15% to the value of Egyptian clothes and 10% to the total value of all goods shipped in the region. It costs companies an average of 95 man-days a year just to deal with trade bureaucracies. It takes longer and is more expensive to ship goods between two Middle Eastern ports than to send them from the Middle East to America. Such market fragmentation, the authors argue, is the consequence of the region's centralised, state-led economic policies.

Just start somewhere

More trade would have familiar benefits: larger markets should enable firms to reap greater economies of scale, increase returns to investment and adopt more new technology. Just as important in the Middle Eastern context, more open trade would begin the process of dismantling over-centralised states and create a constituency for further economic change.

Of course, trade liberalisation is no substitute for privatisation, financial reform and other domestic measures. But it has a political advantage over those reforms. Because the steps required are relatively small ones (reductions in red tape, for instance) they should provoke less resistance from insiders; and because regional trade can be presented as a pan-Arab goal, it does not have the same taint of "Westernisation" that discredited earlier reform efforts. Regional trade would be only a start. But the main thing is to start somewhere. □

* "The economics of the Arab Spring", OxCarre Research Paper 79, Department of Economics, Oxford University, December 2011.

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A L'ATTENTION DES CANDIDATS

- Ne rien écrire sur le texte

- Rendre l'article à l'examinateur avant de quitter la salle