

ERF Policy Brief

Trade and SDGs in the MENA Region: Towards a More Inclusive Trade Policy

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About the authors

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In a nutshell

- *The MENA region liberalized its trade over the last two decades. Meanwhile, non-tariff measures and services restrictions proliferated leading to a distorted trade policy.*
- *Consequently, social outcomes did not improve with such a liberalization. Indeed, wages in protected sectors were generally lower than those in unprotected ones.*
- *Against this backdrop, a more inclusive trade policy can be used as a tool to improve its socio-economic impact and thus help attain some SDGs.*

Trade Policy in the MENA Region: What is at Stake?

Trade policy reforms in the MENA region began in the nineties as part of their comprehensive economic reform and structural adjustment programs. Today, the region is among the most open regions in the world, with exports accounting for more than 40% of their GDP. Out of 21 MENA countries, 13 are WTO members and most MENA countries are members in Preferential Trade Agreements (PTAs), such as the bilateral Association Agreements (AA) with the EU, the Agadir Agreement and the Pan Arab Free Trade Area (PAFTA).

Despite substantial liberalization, trade policy in the MENA region is not inclusive. MENA economies reveal a number of structural issues that are mirrored in their exports and that lead to a disconnection between socioeconomic outcomes and trade policy reforms. These issues include a relatively modest contribution of the manufacturing sector value-added in total GDP (13.1% in MENA countries compared to 25.4% in East Asia and Pacific excluding high income economies), a less diversified manufacturing sector and -most importantly- a humble share of high-tech industries manufacturing activities. In matters of labor, MENA economies are characterized by shortage in skilled labor, the predominance of the informal sector and lack of decent jobs.

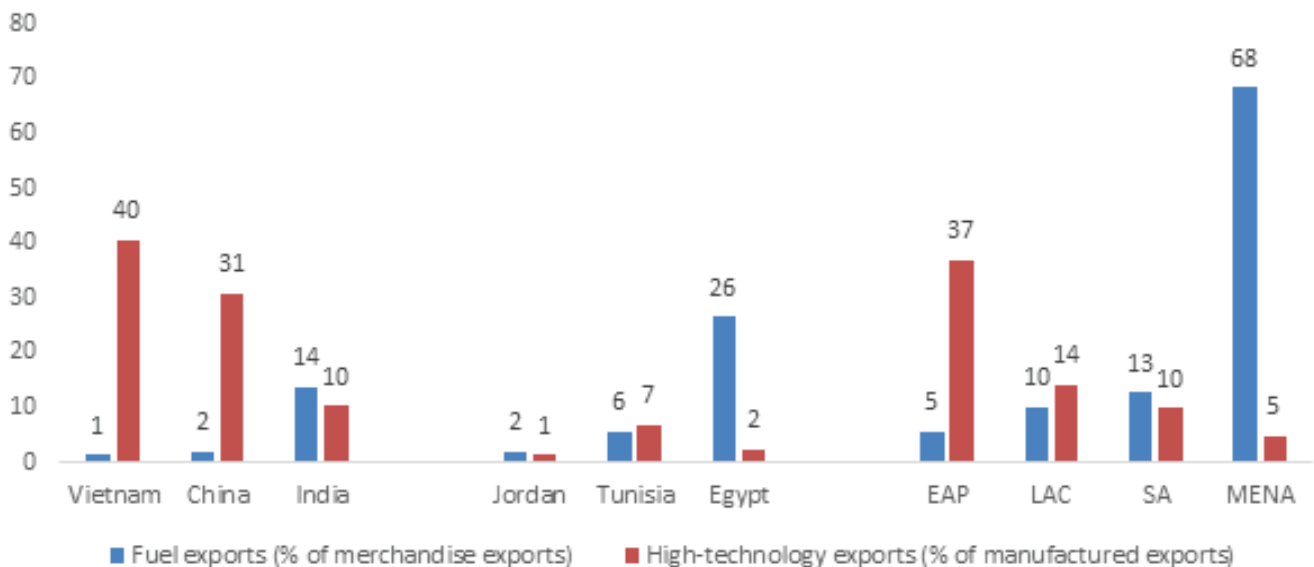
Consequently, MENA exports also lack diversification, complexity, and skilled labor intensity. Across this brief, we will chiefly focus on Egypt, Jordan and Tunisia for whom we have labor market surveys. Moreover, they will be compared to some Asian countries that have a development level similar to them and/or that have a similar comparative advantage in selected sectors.

Figure 1 shows that MENA exports are concentrated in fuel (68% of total merchandise exports). This share exceeds by far that of other developing and emerging economies of South Asia (13%), Latin America and the Caribbean (10%) and East Asia and the Pacific (5%). Within our sample of MENA countries, Egypt's exports of fuel account for 26% of merchandise exports, compared to only 6% and 2% in Tunisia and Jordan respectively. Second, the share of high-tech exports in the region's manufactured exports is very modest, and exports of manufactures are mostly dominated by traditional low value-added products. The structure of exports, as the structure of MENA's manufacturing sector, reveals the predominance of sectors with low labor productivity and high capital intensity. In 2019, MENA countries exported high-tech products accounting for a meager 5% of their total manufactured exports. While this share falls below the region's average for Jordan and Egypt (1% and 2% respectively), it is higher than average for Tunisia. Nevertheless, the sophistication of manufactured exports for MENA is lowest compared to the other developing country groups. The East Asia and Pacific region provides a successful example for export sophistication, with an average share of 37%. This share is as high as 40% for Vietnam.

Figure 2 illustrates the exports complexity index at the global level. This index measures the degree of sophistication of countries' exports and could be considered as an indicator of the level of complexity and diversity of countries' internal industrial capabilities and productive know-how. MENA countries like Libya, Yemen, and Algeria rank among the countries with the lowest exports complexity. Out of 133 countries, Egypt ranks 66th, with a slightly below average performance. Tunisia and Jordan rank 46th and 51st respectively, revealing a slightly complex form of exports. In Tunisia, the exports of electronics and vehicles are the main drivers of complexity. Surprisingly, the map reveals that Saudi Arabia comes in the 36th place, with a promising chemicals sector.

A third long-standing problem in the MENA region is trade protection. Despite significant cuts in tariff rates, the region still counts as one of the most protected regions in the world due to severity of non-tariff measures (NTMs) and restrictive services policies. In fact, the use of NTMs by MENA countries increased over time as an alternative measure to protect domestic producers from competition with imported products. Studies on NTMs in MENA countries suggest that NTMs cover in average 40% of the products imported by MENA countries and 50% of the value of their imports. Most NTMs are technical in nature (TBTs), which represent more than one-third of overall NTMs, followed by Sanitary and Phyto-sanitary measures (SPS). NTMs also represent a challenge to firms trading at the intra-Arab level. In Tunisia (Figure 3), 60% of imported products are subject to at least one NTM, and 70% of its total imports are

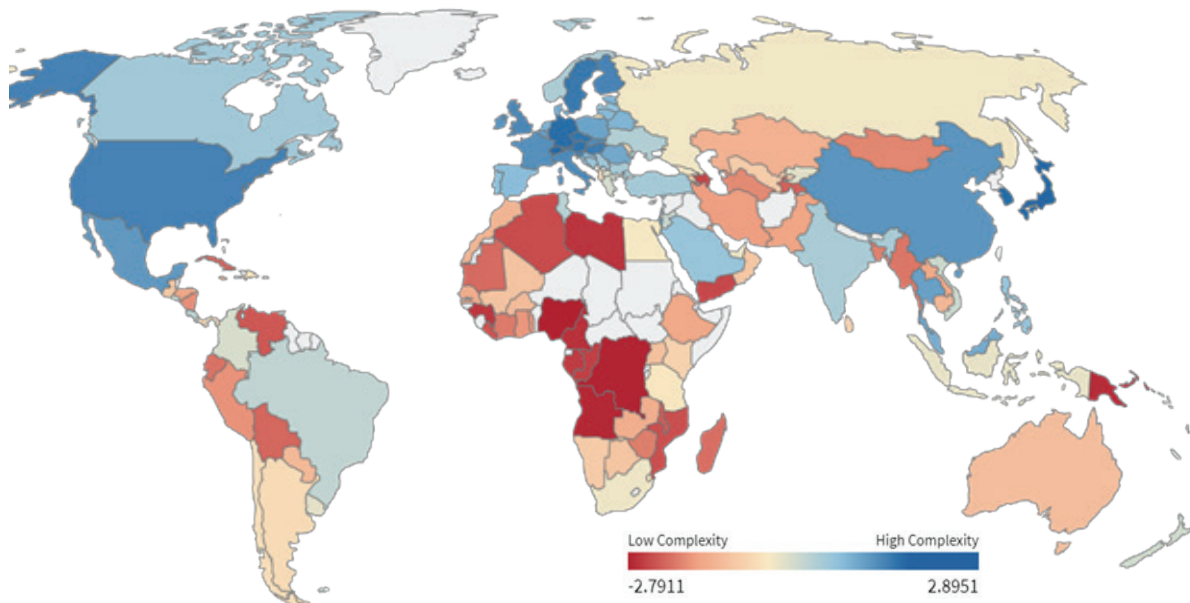
Figure 1: Exports Structure (2019)



Source: Authors' elaboration using the World Development Indicators dataset.

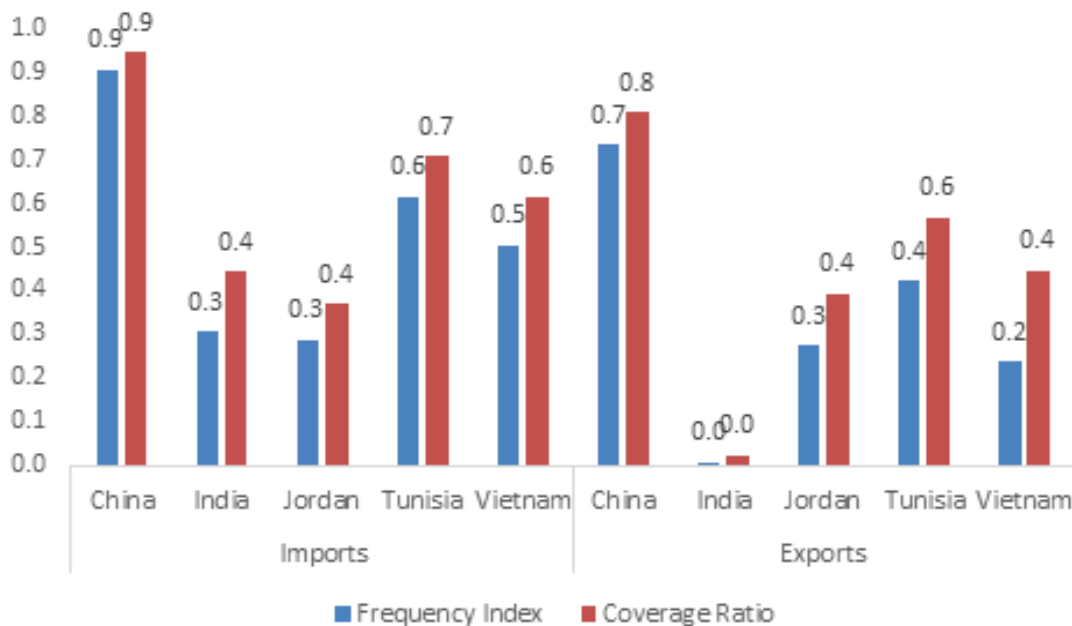


Figure 2: Exports Complexity Index (2018)



Source: Atlas of Economic Complexity dataset.

Figure 3: Non-Tariff Measures in Selected Countries



Source: UNCTAD (2017)

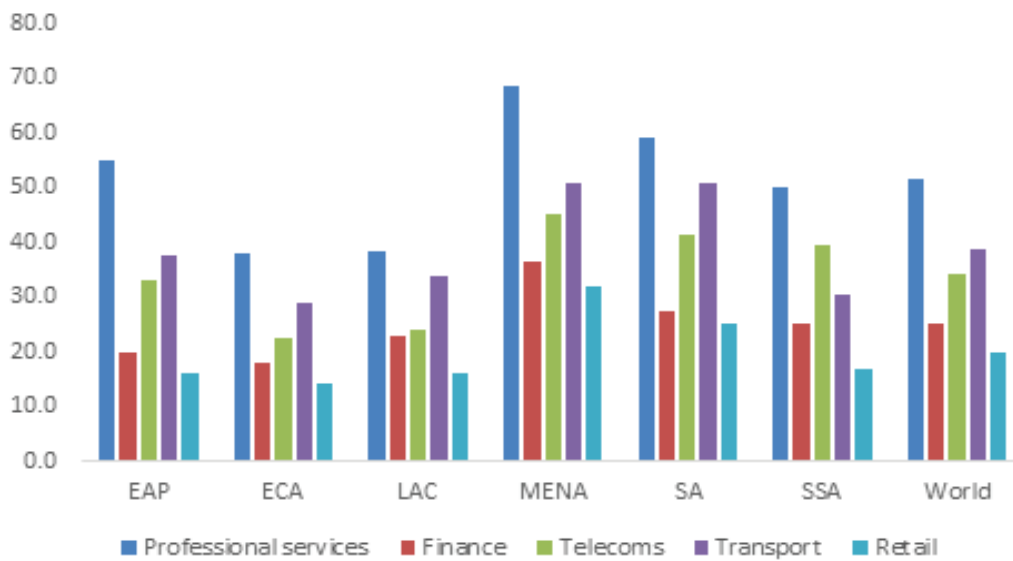
Notes: (i) The Frequency Index (F_i) captures the share of products of country i covered by NTMs. (ii) Coverage Ratio is the share of trade subject to NTMs for a country i (or for a region), or a group of products. (iii). Coverage and Frequency indices range between 0 and 1. The higher the index, the higher the incidence of a non-tariff measure. (iv). Data for Egypt are missing.

covered by NTMs. These ratios are lower for Jordan (30% and 40% respectively). MENA exports are also subject to NTMs imposed by destination markets, especially EU countries. For instance, 40% of Jordanian exports and 60% of Tunisian exports are subject to NTMs. While

China’s trade is heavily distorted by the presence of NTMs, exports and imports of other Asian countries tend to be less affected by the presence of such barriers. In the case of India, for example, the incidence of NTMs is almost zero.



Figure 4: Services Restrictiveness Index (2014)



Source: OECD dataset.

Note: EAP stands for East Asia and Pacific, ECA for Eastern and Central Europe, LAC Latin America and Caribbean, MENA Middle east and North Africa, SA South Asia, SSA Sub-Saharan Africa.

In addition to NTMs, policies governing trade in services in the MENA region are quite restrictive. A number of MENA countries committed to liberalize their services sectors within the GATS. However, liberalization outcomes are offset by the presence of burdensome and unnecessary regulations behind the borders (such as complex licensing procedures for investors). Figure 4 shows that the MENA region has the highest restrictiveness index for professional services, compared to other developing and emerging economies. Substantial policy restrictions are also present in transport services, followed by telecommunications, finance and retail services. There is growing empirical evidence that lifting unnecessary restrictions on services fosters competition and enhances the price-quality combination of services. Services such as transport and telecommunications act as a backbone for the economy. Hence, increased efficiency of these services generates positive outcomes for a country's overall competitiveness. Services are also characterized by strong forward and backward linkages, acting as inputs in the production process or support services to the final product. Some services also act as the "glue" that holds together fragmented activities of a product value chain. From a global perspective, efficient services provision has important implications for MENA countries: increased efficiency from lifting restrictions on services not only generates productivity gains and increases export competitiveness, but it also allows MENA countries to increase their participation in regional and global value chains (GVCs).

On Trade Barriers and Inequalities

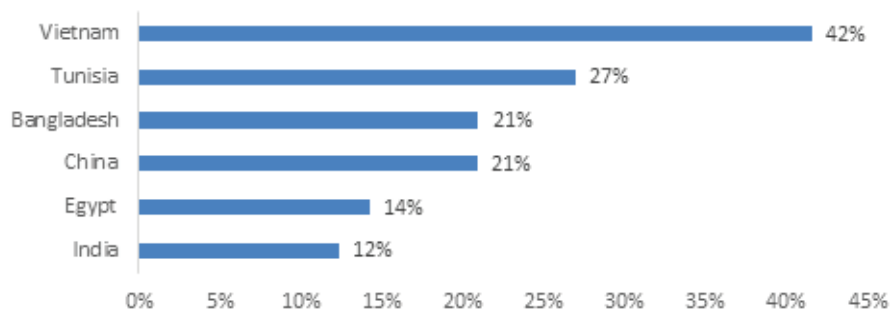
Against this background, it is important to analyze the social outcomes of trade policy. In fact, MENA's exports being either capital-intensive (as in the case of fuel) or heavily relying on unskilled labor (as in the case of traditional non-oil sectors), do not create enough jobs. For instance, the share of domestic labor value added included in exports to that in output (Figure 5) is only 14% in Egypt, and 27% in Tunisia, compared to 42% in Vietnam. Meanwhile, this ratio is of 21% for China and Bangladesh, and only 12% in India.

The impact of trade policy on inequalities in the MENA region is not uniform. Data from the labor market surveys show that wages in low-tariff sectors are found to be slightly higher than wages in high-tariff sectors. Sectors with high tariffs are artificially protected from international competition, with little motivation to increase productivity and lower costs and prices. Meanwhile, in sectors with high NTMs or those which rely on highly protected services, wages are lower than those in sectors with no NTMs or low services protection (Figures 7 and 8). This is because the absence of this type of barriers provides access to imported inputs (goods and services) that contribute to increased productivity, hence higher wages.

In a nutshell, the higher the protection level (whether because of tariffs, non-tariff measures, and services restrictions), the lower the level of hourly wage. Thus,



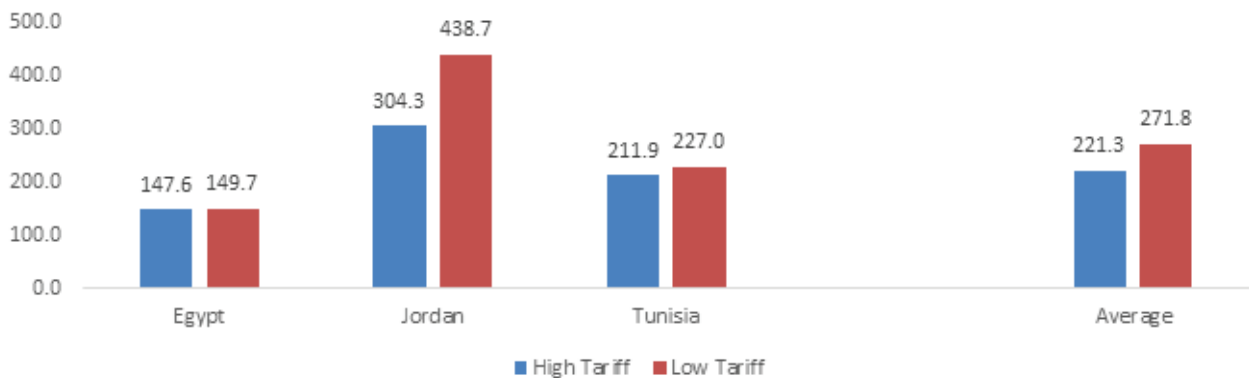
Figure 5: Share of the total domestic labor value added embodied in exports to that in output



Source: Authors' elaboration using WITS dataset.

Note: The total domestic labor value added embodied in a sector's exports (output) refers to wages paid directly for the production of the sector's exports (output) and indirectly via the production of economy-wide inputs for the sector's exports (output) (measured in millions of nominal US\$)

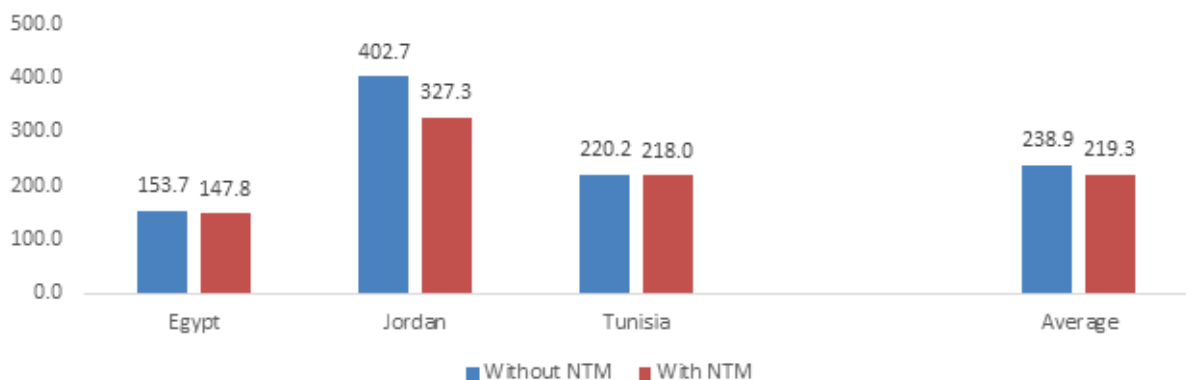
Figure 6: Wages and Tariffs



Source: Aboushady et al (2019) using ILMPS.

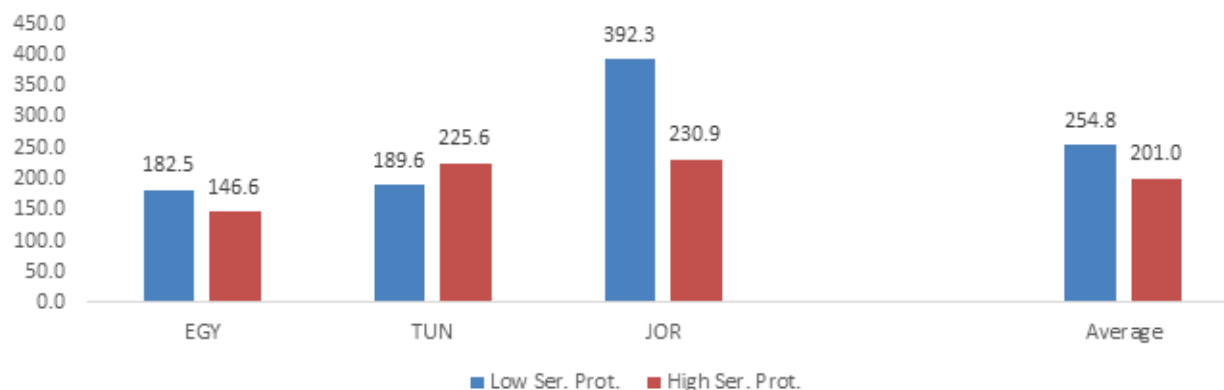
Note: (i) Figures represent real monthly wage in constant USD (2010). (ii) High tariff means a sector with a tariff greater than the median one.

Figure 7: Wages and NTMs



Source: Aboushady et al (2019).

Note: (i) Figures represent real monthly wage in constant USD (2010). (ii) With NTM means that there is a least one non-tariff measure imposed on this sector.

Figure 8: Wages and AVE of Services

Source: Aboushady et al (2019) using ILMPS.

Note: (i) Figures represent real monthly wage in constant USD (2010). (ii) High Ser Prot. means a sector with an AVE of services greater than the median one.

trade policy can be perceived as a tool that can clearly affect inequality and that is why it can be used a tool to achieve SDGs.

Towards a More Inclusive Trade Policy

Trade as tool for lower inequalities (SDG5 and SDG10)

Inequality is observed at the skill and the gender level. Indeed, the literature has shown that the higher the level of openness, the higher the demand for skilled labor leading larger inequalities between skilled and unskilled workers (Feenstra and Hanson, 1994). In contrast, inequality between females and males is likely to decrease since, in a competitive framework, the demand for females shall increase.

Figures 9 and 10 demonstrate the wage gaps between skilled (non-production) and unskilled (production) labor and between males and females respectively. These gaps are the widest for Jordan and narrowest in Tunisia. Narrower skill- and gender wage gaps in Tunisia could be explained by higher female education attainment and employment. Additionally, Tunisia has a relatively more diversified exports structure, which increases demand for skilled and unskilled labor.

Hence, trade liberalization represents an opportunity for MENA countries to reduce inequalities in line with their SDG agenda (promoting gender equality (SDG 5) and reducing inequalities (SDG 10)). Since liberalization allows firms to use foreign inputs to increase the quality

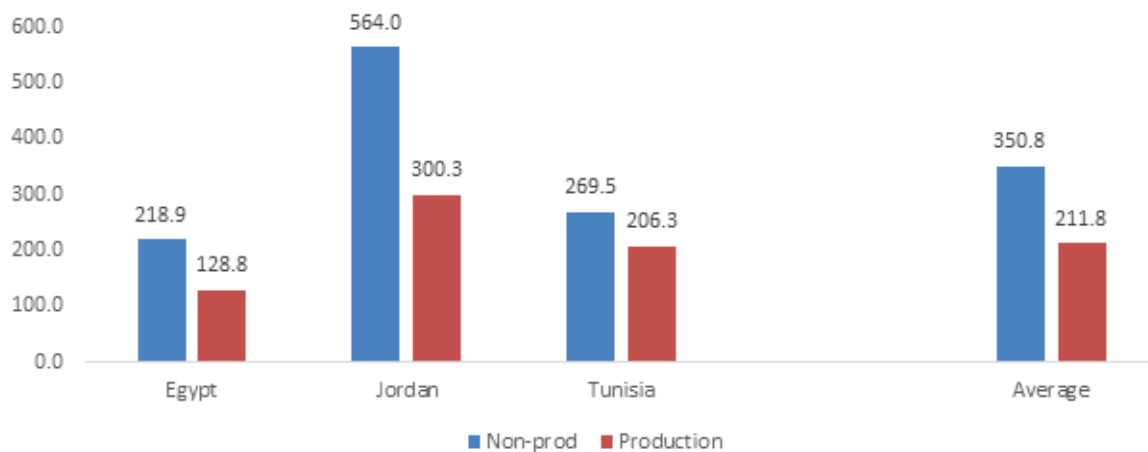
and sophistication of their output, this leads to increased labor demand, increased wages, and reduced wage disparities from the skill and gender lens. Moreover, Aboushady and Zaki (2021) find that exports and innovation in core production techniques increase the demand for skilled production (blue-collar) workers in the manufacturing sector rather than non-production workers (white collars). From a development goal perspective, this effect corresponds to the goal of creating jobs that are more decent and reducing informality. However, a major problem in the MENA region is limited employability and skill shortages in blue-collar workers. Additionally, female workers are concentrated in low value-added sectors and in the informal sector. Therefore, inclusive trade policy needs to be accompanied by public private cooperation in order to enhance vocational training and create skilled labor, while considering the gender dimension as well.

On Trade, Industry and Innovation (SDG9)

In line with the SDGs, MENA countries also need to work on promoting inclusive industrialization and fostering innovation. In the MENA region, industrial policies are not inclusive, since manufacturing exports are relatively modest and -due to concentration in low value-added or capital-intensive sectors - are not generating enough jobs. The share of innovative firms is also lower in the region than in other developing countries (Aboushady and Zaki, 2021). Therefore, firms must be encouraged to innovate in order to be able to enter the exports market and withstand global competition. It is vital that governments, in coordination with businessmen, trade unions and Civil Society, work on developing industrial strategies that foster inclusiveness through employment creation. These



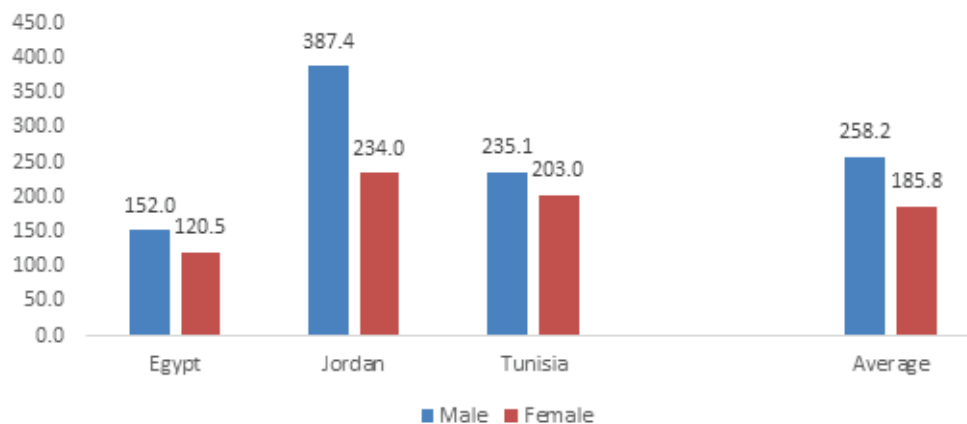
Figure 9: Average Wage by Skill and Country



Source: Aboushady et al (2019) using ILMPS.

Note: (i) Figures represent real monthly wage in constant USD (2010). (ii) Non production workers include managers, professionals, technicians and associate professionals, clerical support workers and service and sales workers.

Figure 10: Average Wage by Gender and Country



Source: Aboushady et al (2019) using ILMPS.

Note: (i) Figures represent real monthly wage in constant USD (2010). (ii) Variance scaled to handle strata with a single sampling unit.

should rely not only on promoting traditional labor-intensive sectors, but on exploring new diversified and innovative paths that could contribute to the creation of more jobs for the skilled.

Fostering Deeper Trade Integration (SDG17)

Regional and global partnerships could play an important role in promoting inclusiveness in the MENA region. For a number of MENA countries, the EU is the main trade partner. However, the framework governing MENA-EU trade integration remains shallow, exclusive and fails to

contribute to job creation. Bilateral Association Agreements cover only manufacturing products, to a lesser extent agriculture, while services remain completely excluded. FDI is one of the main motors of growth and job creation. Yet, EU investments in the region are concentrated in capital intensive sectors, such as oil, banking and real estate. Compared to the manufacturing sector, there is little room for innovation and employment of skilled labor in these sectors. Given the current production and trade structure, deeper integration may worsen the situation in terms of unemployment and jobless growth. Therefore, MENA countries can make use of the Euro-Mediterranean Partnership to seek assistance in developing and



implementing inclusive industrial policies and in aligning these with their trade policies, before proceeding with deeper integration. The EU instruments and funds could be used in the design and implementation of such trade and industrial development strategies, be it through enhanced vocational training, fostering innovation through increased access to financial resources and know-how, enhancing the access of small and medium enterprises (SMEs) to regional and global markets through clusters or promoting sectors with high female labor intensity.

Further reading

Aboushady, N. and Zaki, C. (2021) “Do Exports and Innovation Matter for the Demand of Skilled Labor?”, *International Review of Applied Economics*, vol. 35 no. 1, pages 25-44.

Aboushady, N., Kamal, Y. and Zaki, C. (2019) “Disentangling the Impact of Trade Barriers on Wages: Evidence from the MENA Region”, EMNES Working Paper No 26.





ERF at a Glance: *The Economic Research Forum (ERF) is a regional network dedicated to promoting high-quality economic research for sustainable development in the Arab countries, Iran and Turkey. Established in 1993, ERF's core objectives are to build a strong research capacity in the region; to encourage the production of independent, high-quality research; and to disseminate research output to a wide and diverse audience. To achieve these objectives, ERF's portfolio of activities includes managing carefully selected regional research initiatives; providing training and mentoring to junior researchers; and disseminating the research findings through seminars, conferences and a variety of publications. The network is headquartered in Egypt but its affiliates come primarily from different countries in the region.*

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