Middle East Institute
Regional Cooperation Series

June 2016

Economic Integration in the Middle East

Prospects for Development and Stability

Shahrokh Fardoust

MEI Policy Paper 2016-5

The author would like to thank, without implicating, Ross Harrison and Paul Salem for their advice and suggestions on the concept note for this paper as well as on the first draft of the paper. The author is also grateful to Bernard Hoekman and Adnan Mazarei for suggestions on major trade and macroeconomic policy issues facing the region and to Mansoor Dailami and Shidan Derakhshani on the regional financial issues.

The Middle East Institute
1761 N Street NW
Washington, D.C. 20036

Follow MEI:

@MiddleEastInst

/MiddleEastInstitute

/user/middleastinstitute

MEI Policy Paper 2016-5

Economic Integration in the Middle East

Prospects for Development and Stability

Shahrokh Fardoust

Middle East Institute
Regional Cooperation Series

Abbreviations

ASEAN	Association of Southeast Asian Nations
ECO	Economic Cooperation Organization
F.D.I.	foreign direct investment
G.C.C.	Gulf Cooperation Council
G.D.P.	gross domestic product
I.C.T.	information and communications technology
I.M.F.	International Monetary Fund
MENA	Middle East and North Africa
NAFTA	North American Free Trade Agreement
PAFTA	Pan-Arab Free Trade Agreement
P.T.A.	preferential trade agreement
SMEs	small and medium-sized enterprises
S.W.F.	sovereign wealth funds
T.F.P.	total factor productivity
T.P.P.	Trans-Pacific Partnership
T.T.I.P.	Transatlantic Trade and Investment Partnership
U.A.E.	United Arab Emirates
W.T.O.	World Trade Organization

Contents

Summary

The region has incurred huge economic and social losses from poor economic management and conflicts requiring massive military outlays. A policy shift is needed to deploy its substantial human, natural, and financial assets more efficiently through adopting economic and social policies that lead to more rapid and inclusive economic growth for the region. The four most powerful players in the region—Saudi Arabia, Egypt, Iran, and Turkey—need to spearhead regional political and economic stabilization to address the root problems. Major regional infrastructure projects in energy, water, and transport are needed to better integrate their economies and expand intra-regional and world-wide trade.

This policy paper argues that the major regional players should each follow a coherent long-term development strategy requiring four prongs plus cooperation:

1. Reduce regional tensions and end conflicts through diplomacy and by recognizing that the current approaches are impeding investment and economic growth.
2. Undertake significant economic and institutional reforms at home to remove binding constraints on growth, revitalize the private sector, improve financial access by small and medium-sized businesses, and improve the quality of education.
3. Focus on well-targeted policies and structural reforms that would lead to significant reductions in youth employment and increased female labor force participation; and introduce cuts in military expenditures as regional tensions subside, and reallocate public investment savings to clean energy and infrastructure investments.
4. Increase inter- and intra-regional cooperation and trade, initiate regional projects in partnership with the private sector in areas such as tourism, air and ground transport, regional energy and water, regional health and education, and research hubs.

To support these initiatives, a regional development and reconstruction program supported by a 'mini-Marshall Plan' is urgently needed.

Introduction

The global economic slowdown, and the macroeconomic and financial challenges it has wrought, as well as key regional megatrends, create daunting policy challenges for governments across the Middle East and North Africa (MENA). An inhospitable business climate, weak governance, and lack of sufficient economic integration have stifled the region's ability to tap its significant potential for economic growth and job creation to address high youth unemployment and very low female labor force participation. The region's limited integration into the global economy, the lack of diversification of its production base, and its low productivity growth will make it difficult to accelerate economic growth at a time when commodity prices have declined sharply and there is little room for accommodating fiscal or monetary policies.

This paper highlights the important role the largest and most powerful players in the region—Saudi Arabia, Egypt, Iran, and Turkey—could play in spearheading stabilization of the political and economic situation in the region and addressing root problems. It argues that instead of continuing to incur huge losses from poor economic performance and costly conflicts, which have required massive military outlays, the region should use its substantial human, natural, and financial assets more efficiently, adopting economic and social policies that would lead to rapid and inclusive economic growth for the entire region.

Given the region's massive economic needs and resource constraints and the fact that political unrest and the civil wars in Syria, Iraq, and Yemen must be quieted as economic remedies are implemented, a regional development and reconstruction program is urgently needed. World powers, led by the United States and including Europe, China, and Russia, as well as the regional powers (Egypt, Iran, Turkey, Saudi Arabia, and the other G.C.C. countries) should bring together the international donor community to lay out the basis for a mini–Marshall Plan for the region.

"The region's limited integration into the global economy... will make it difficult to accelerate economic growth."

Background

Political and economic crises have engulfed large segments of the MENA region since 2011, with disastrous human and economic consequences. A crescent of instability now extends from Libya into the Sinai, the Occupied Palestinian Territories, through Syria, Iraq, and Yemen. The region as a whole continues to experience low economic growth, as a result of regional conflict and the adverse effects of lower oil prices on the oil exporters within the region. As a consequence, real G.D.P. growth for the region, which had averaged about 4 percent a year over the last two decades—compared with 5.5 percent for emerging economies and developing countries as a whole—has grown by only about 2.8 percent a year (less than 1 percent a year in per capita terms) since 2012.[1] The slowdown has weakened the region's already fragile economic structure and increased poverty and youth unemployment.

"Real G.D.P. growth for the region has grown by only about 2.8 percent a year."

To date the region has "muddled through" these problems. Given the political instability and weak economic performance of much of the region, continuing to do so could quickly deteriorate into deeper economic stagnation and eventually to chaos and destruction, as has already happened in parts of the region, with adverse global consequences.

Purpose and Scope of the Paper

This policy paper, which focuses on the economic aspects of the region's long-term prospects, poses three important questions and identifies policies and conditions that would address them in ways that would help stabilize the region and put it on a sustainable and inclusive growth path:

- What are the key economic and social dimensions of the current situation in MENA?
- What fundamental factors and policies led to the region's economic and social deficits despite its massive resources and financial wealth?

- What steps do the leading countries in the region need to take in terms of economic and institutional reforms to address regional challenges and provide substantially better outcomes for the region's citizens?

The approach emphasizes the important role that the largest and most powerful players in the region—Egypt, Saudi Arabia, Turkey, and Iran, which together account for about 70 percent of the region's $4 trillion economy and are home to about 285 million of its 485 million inhabitants[2] —could play in spearheading the stabilization of the situation and addressing root problems.[3] Global and regional megatrends, ranging from demographic and climatic changes to disruptive technologies, are likely to intensify the challenges faced by MENA governments, further weakening them unless they decide to act jointly in addressing them.[4]

A key message of this paper is that the most serious downside risks to long-term stability will continue to arise from poor governance and weak institutions; the weak business climate; inadequate infrastructure; low economic growth; high unemployment rates, particularly among educated youth; growing disparity in income and wealth; and shortages of water and emerging food insecurity across much of the region.

"Global and regional megatrends are likely to intensify the challenges faced by MENA governments."

Two major interrelated initiatives could spur growth:

- Undertaking internal economic and institutional reforms to accelerate growth and job creation - while enhancing productivity and competitiveness, and introducing well-targeted polices in each country that reinforce the reforms by addressing the most binding constraints on private sector–led growth. These constraints have caused serious distortions, leading to high unemployment rates among educated youth, very low labor participation rates among educated women, high defense budgets in response to perceived and largely self-generated internal threats and pointless intra-regional rivalries, and the creation of the least economically integrated region in the world.

- Implementing major regional infrastructure projects in energy, water, and transport (ground and air transport) to substantially improve links among the major countries in the region and deepen trade integration within the region and with the rest of the world.[5] Doing so could yield large direct gains from higher exports and productivity-enhancing F.D.I. and catalyze reforms in other areas that help countries compete, such as improved access to markets in advanced economies, reductions in tariffs and nontariff trade barriers in the region, and the increasingly important areas of trade facilitation and export promotion.

Domestic reforms, together with a few win-win regional projects, could proceed even without a comprehensive regional political and security agreement. But these initiatives are more likely to be implemented and bear fruit if the region's big players act in unison, through diplomacy and with the support of the international community, to put an end to regional conflicts and substantially reduce tensions. By reducing risks and uncertainty, a well-coordinated regional strategy is likely to substantially raise the pace of growth, leading to a gradual but steady decline in the rate of unemployment, the increased productivity and competitiveness of the regional economy, and greater social and political stability.

"By reducing risks and uncertainty, a well-coordinated regional strategy is likely to substantially raise the pace of growth."

The Global Context and the Current Economic Situation in the Region

The pace of growth of the world economy remains modest and fraught with downside risks, as the latest forecasts by the I.M.F. and the World Bank indicate.[6] Recovery in the advanced economies is expected to continue to be slow and uneven. In many emerging economies and developing countries, the economic situation is becoming increasingly diverse and challenging, as a result of falling exports, massive capital outflows, depreciating currencies, and high and rising public and private debt, which taken together will continue to reduce their growth prospects over the medium term. The slowdown of the Chinese economy, the second largest in the world, has been an important factor in the plummeting of commodity prices, including oil prices. The sharp decline in commodity prices and capital outflows has had a severe adverse effect on the economic performance of many countries that rely on commodity exports, particularly the oil and gas exporters in MENA.

Growth could pick up in the next two-to-three years, mainly as a result of the lifting of the nuclear-related sanctions against Iran, the region's third-largest economy (after Saudi Arabia and Turkey), but new waves of political and economic shocks could frustrate even a modest recovery. Indeed, major risks to the global economic outlook, as well as to the region's economy, remain tilted toward the downside. They emanate mainly from a generalized slowdown in emerging market economies, China's rebalancing, further declines in oil and other commodity prices, the likely end of extraordinarily accommodative monetary conditions in the United States, and continued conflict in MENA.

"Growth could pick up in the next two-to-three years, mainly as a result of the lifting of the nuclear-related sanctions against Iran."

Politically, economically, and socially, MENA has changed dramatically since the 1970s. Forty years ago, much of the region was growing relatively rapidly, and the locus of tension and change was limited largely to the Arab-Israeli conflict, the Soviet occupation of Afghanistan, and the beginnings of internal political turmoil in Iran. Today, much of the region is engulfed in what seems to be open-ended chaos, with the real possibility of changing borders, collapsing states, and spillovers into neighboring regions. The chaos is fueled primarily by intra-regional political rivalries among the larger regional players and an army of unemployed and disgruntled youth. Disruption on such a scale has not been seen since the fall of the Ottoman Empire a century ago. It has been argued that pressures were mounting in several Arab countries and that it was only

> "A youth bulge resulted in high rates of unemployment among the 15–25 age group."

a matter of time before an unravelling of the regional order occurred. But the following factors contributed to the speed with which the protests spread across the region:

- The pace of economic growth (and the non-inclusive nature of that growth) in most regional countries was insufficient to generate enough jobs in the private sector to absorb the rising number of entrants into the labor force.[7]
- A youth bulge resulted in high rates of unemployment among the 15–25 age group, and employment prospects weakened, as the state-dominated growth machine began to slow.
- Wages stagnated or fell in terms of their purchasing power, as food and fuel prices rose rapidly.
- Income and wealth disparities grew and became increasingly visible.
- The Great Recession of 2008–09 exacerbated feelings of insecurity.
- Social media and television networks like *Al Jazeera* increased awareness of political and economic realities across the region and elsewhere in the world.
- Regimes were repressive and corrupt.

The domino-like fall of Arab regimes that swept away Ben Ali in Tunisia, Mubarak in Egypt, Qaddafi in Libya, and Saleh in Yemen was perhaps too hastily dubbed the Arab Spring.

Global and Regional Megatrends through 2030

In the course of the 21st century, the world economy will be transformed beyond recognition, driven by forces that are only now beginning to be understood.[8] Some of these forces will be of direct relevance to current conditions and the future of citizens of MENA:

- Over the next two decades, demographic changes and fundamental forces of convergence and competition are likely to bring about massive shifts in both the sectoral and geographical composition of global output and employment.[9] The center of gravity of the global economy is already moving toward Asia.

  MENA's share of exports to Asia more than doubled, to 38 percent, over the past decade.

- Developing countries will face stronger headwinds in terms of growth and employment generation in the decades ahead, both because the global economy is likely to be significantly less buoyant than in recent decades and because technological changes are rendering manufacturing (and some services) more capital- and skill-intensive. Ultimately, growth will depend primarily on what happens at home in almost all economies.

  The economic future will be particularly challenging for MENA, because the manufacturing sector in most of the region was not able to take advantage of global markets in the last two decades. Indeed, the share of manufacturing in G.D.P. fell in nearly all of the region's major economies.

- Recent unprecedented changes in the quantity, quality, and mobility of the population will continue to affect the world throughout the 21st century, with important differences across countries, depending on the stage of the demographic transition and the level of economic development. The world's population is projected to grow by 1.5 billion (and the working-age population by 900 million) between 2010 and 2030, to 8.5 billion. It will be increasingly concentrated in Asia and Africa, and population mobility is likely to lead to substantial urbanization.

  The population of MENA and Turkey is projected to increase by 125 million people—to 610 million—by 2030.

"The population of MENA and Turkey is projected to increase by 125 million people—to 610 million—by 2030."

- The open, rules-based global trading system has delivered immense benefits—for the world, for individual countries, and for average citizens in these countries. It can continue to do so, helping today's low-income countries make the transition to middle-income status. Rich countries must sustain the social consensus in favor of open markets and globalization at a time of considerable economic uncertainty and weakness. The rising powers, especially China and increasingly India, will have a key role to play in resuscitating multilateralism.

  Total trade in goods as a percent of G.D.P. has been hovering around 60 percent in MENA, indicating a relatively open regional economy (the figures are 48.5 percent for all developing countries and 50 percent for advanced economies).[10] There is substantial variation in the extent of openness of the economy to international trade within the region, however, with the ratio of trade to G.D.P. ranging from 35 percent in Egypt and Iran to about 100 percent in a number of G.C.C. countries. The region as a whole has not been successful in exporting manufactures, is only minimally involved directly in global supply chains, and is the least integrated region in the world. Some G.C.C. countries have been more successful than the rest of the region in exporting services, however.

"Total trade in goods as a percent of G.D.P. has been hovering around 60 percent in MENA, indicating a relatively open regional economy."

- Finance has been, and will continue to be, beneficial for economic growth. But excessive finance can retard growth, by incubating economic booms and asset price bubbles that end in financial crises, followed by low rates of economic growth. Reform of the global financial architecture and the rapid growth of inclusive finance are among the most important requirements of a more stable and inclusive future financial system.

Many countries in MENA implemented financial reforms to strengthen their banking systems and promote financial development over the past decade, but the reforms were inadequate. Except in some G.C.C. countries, the region's financial systems remain excessively bank-based and uncompetitive. Inadequate access to finance, particularly by small and medium-size enterprises (SMEs), has contributed to the low rate of economic growth and high rate of unemployment in much of the region.

- Current patterns of energy and natural resource use, agricultural practices, and urbanization appear to be largely unsustainable and require urgent remediation. Left unchecked, they will lead to dangerous climate change and reduced economic growth, as a result of higher economic, social, and environmental costs and lower productivity. The good news is that raising energy and resource efficiency can lead to relatively large win-win gains. Smart policies combining carbon pricing and directed investment in research can increase investment, growth, and competitiveness. Providing long-term policy confidence about the price of carbon and the associated risks of stranded assets can increase investment. A variety of policies—including removing subsidies on fossil fuels, pricing carbon, and facilitating citizens' voice through the marketplace—will play important roles in putting economic processes on a more sustainable footing.

"Raising energy and resource efficiency can lead to relatively large win-win gains."

MENA's high and poorly targeted fuel subsidies and inadequate environmental regulations have led to serious environmental problems across the region. The decline in oil prices and the resulting budgetary pressures have resulted in the removal of some subsidies, but much more needs to be done. Massive investments in clean energy and infrastructure are needed. The region is facing serious water shortages: by 2040, 19 of the 33 most water-stressed countries in the world will be in MENA.[11] Most of them are already heavily dependent on food imports.

- The politics, rules, and institutions of cooperation among countries have not kept up with the demands from global citizens for changes in the global political order. A billion people moved out of extreme poverty in the past quarter century, social indicators improved in many emerging economies and developing countries, and world income inequality stabilized or declined as a result of the relatively rapid growth of large emerging economies such as China and India. Nevertheless, the challenges remain enormous. Whether norms and policies can make the politics of managing the global economy more effective, legitimate, and responsive to the needs of the bottom half of the world's population remains to be seen. But the time has come to think seriously about how improvements in official global governance, coupled with and reinforced by rising activism of 'global citizens,' can lead to welfare-enhancing and equitable results for global citizens through better national and international policies.[12]

"By 2040, 19 of the 33 most water-stressed countries in the world will be in MENA."

Over the past decade, sharply rising oil revenues enabled the major oil producers in MENA, particularly the G.C.C. members, to become far more influential on the global scene, through their massive financial resources (international reserves and S.W.F.). However, because of weak political institutions and serious governance and human rights issues, their elevated role in the international economy has not yet translated into empowerment of their citizens or led to increased cooperation at the regional level outside the G.C.C.

Longer-term megatrends, ranging from demographic and climatic changes to disruptive technologies, compound the region's short-term economic, social, and political challenges, further weakening the governments in the region unless they act jointly in addressing them through regional cooperation, coupled with deep domestic reforms.

To assess the impact of the above-mentioned megatrends on the MENA region, it would be useful to divide them into four sets of issues.

Issues Set 1: The New Demographic Reality

- The key trend for the region is the large cohort of people 15–24 combined with rapid urbanization. Very high unemployment rates among the region's youth (about 30 percent in 2014)—a key force behind the "Arab Spring"—are fomenting radicalization and violence. If enough private sector jobs could be created to absorb all new entrants into the labor force, the youth bulge could become a strong positive force, as it was in East Asia a decade ago, in support of higher economic growth: the "demographic dividend" could potentially raise economic growth by 1–2 percentage points a year. If the economic stagnation that has engulfed much of the region continues for several more years, the demographic dividend could turn into even more massive youth unemployment and social and political instability. However the youth bulge is handled, it will eventually give way to an aging population, imposing economic and social costs. By 2030, the window of opportunity for higher growth through the demographic dividend will already have started to close for most countries in the region.

> "If enough private sector jobs could be created to absorb all new entrants into the labor force, the youth bulge could become a strong positive force."

- The number of unemployed university graduates is rising, with important political and social implications. This issue is a particularly serious one for the larger countries in the region. There are also a serious mismatch of skills and quality issues that compound the employment problem, including a lack of available talent, as a result of an insufficient number of qualified students coming out of the education system.[13] The quality of education is another serious issue confronting nearly all regional states. [14]

“Real G.D.P. losses from economic gender gaps could be as much as 25-35 percent for several countries in the region.”

- In nearly all MENA countries, female labor force participation remains extremely low (10–20 percent) by developing country standards. The MENA region’s real G.D.P. losses from economic gender gaps could be as much as 25–35 percent for several countries in the region.[15]

- Weak health, social security, and pension systems are under pressure, and there is a risk of further fiscal deterioration and a decline in the quality and coverage of the services provided, particularly in the region’s more populous and poorer countries.

Issues Set 2: Growing Inequality and Weak Per Capita Income Growth

- Globally, income inequality is decreasing between countries, but increasing within countries. In MENA, both between- and within-county inequalities—as well as strong perceptions of inequity—are projected to continue to rise, possibly creating further social and political instability.[16]

- Higher-income groups in the region are likely to continue to benefit disproportionately from global, regional, and national income growth, increasing the concentration of wealth and power, because most countries in the region, particularly its oil exporters, lack effective and progressive systems of taxation and well-targeted social welfare spending.

- Under the current set of policies (the muddling-through scenario), per capita income growth is likely to continue to remain very low and lag the world average. As a result, the growth of the middle class in MENA is likely to be slower than elsewhere.

Issues Set 3: The Environment, Climate Change, Water Shortages, and Emerging Food Shortages

- MENA is the most water-scarce region in the world. Environmental pollution and lack of water will increasingly become severe constraints to health and socioeconomic development in all countries in the region by 2030.
- Groundwater and desalination are the only viable sources of water in the region. Both require huge amounts of energy and massive investments in infrastructure, which only the richest countries can afford.
- Simmering discontent over high food prices boiled over in some of the poorest and most unequal countries in the region in 2010–11. Water shortage was one of the key factors triggering widespread revolt in Syria. With increasingly volatile weather affecting harvests and global inventories set for further declines, the situation is not expected to improve soon; high volatility in agricultural commodity prices is here to stay.
- Increases in the world's population and the growth of the middle class could strain demand for food and natural resources. Given that MENA is already the world's largest net food importer and most of the countries in the region face water shortages, more severe shortages and price spikes could occur, disproportionately hurting the lower and middle classes.

Issues Set 4: Weak Governance, Political and Social Pressures, and the Emergence of Social Media

- Governance and institutions are weak in many MENA states. Trust in institutions has declined and their legitimacy challenged in nearly every country in the region.

"Water shortage was one of the key factors triggering widespread revolt in Syria."

- Social and political pressures on the lower and middle classes are likely to result in further alienation from the current economic and political system, particularly by youth.

- New technologies and social media are having transformative impacts on individual empowerment in parts of the region where individual freedom, particularly for women and ethnic and religious minorities, is severely limited. The Internet has become a proxy for freedom of opinion and even political parties. In general, there is a positive correlation between Internet penetration and democratic reform. Although it is not clear whether online activism in the region has translated into offline participation, the potential for it to do so is there.

"In general, there is a positive correlation between Internet penetration and democratic reform."

Table 1 summarizes some key economic and social development indicators, as well as the currently projected real per capita income growth trajectories of the major economies in the MENA region over the medium- to long-term. The projections assume the continuation of current country-level policies (that is, no deep reforms and limited regional cooperation and trade integration). The projection figures are based on the assumption that the region or the global economy does not experience any major, long-lasting adverse shock over the next decade or so.

Table 1. Selected Economic and Social Indicators for the Middle East and North Africa

	Population 2014 millions	Projection Population 2030 millions	Youth Literacy rate %, (latest available)	Youth unemployment rate, males % 2014	Female Labor-force participation rate % 2014	Military Expenditures Percent of G.D.P. 2014	G.D.P., PPP U.S. dollars billions 2014	G.D.P. PPP $ per capita, 2014	G.D.P. per capita growth % per year 2012-15	Projection G.D.P. per capita growth % per year 2015-2030
Middle East and North Africa[a]	485.0	610.0	91	27	20	6.0	7,800.0	16,080	1.1	1.2-2.0[b]
Egypt	89.6	117.0	92	33	24	1.8	919.2	10,280	0.7	1.7-2.6[c]
Iran	78.1	88.5	98	26	17	2.2	1,280.2	16,580	-2.0	2.0-4.0[c]
Saudi Arabia	30.9	39.1	99	22	20	10.8	1,549.8	51,320	1.7	0.5-1.5[c]
Turkey	75.9	87.7	100	17	29	2.2	1,441.0	18,980	2.0	2.6-2.5[c]
G.C.C.	51.6	65.7	98	12	35	7.2	2,939.2	57,410	1.7	1.0-1.5[c]
Maghreb[d]	90.1	108.2	92	28	32	3.7	1,013.3	11,246	2.4	2.2-3.7[c]
All Developing Countries	5,861.9	6,873.5	89	13	50	1.9	51,651.0	8,811	3.7	3.0-4.0[c]

Source: : Data from World Bank, World Development Indicators, 2015; and United Nations, World Population Prospects: The 2015 Revision, New York; Conference Board (January 2016); U.S. Energy Information, Agency (International Energy Outlook, 2014); PwC, World in 2050(February 2015); OECD, Looking to 2060: Long-term Global Growth Prospects (November 2012); short- to medium-term projections are based on several sources, including World Bank, Global Economic Prospects (January 2016); I.M.F., World Economic Outlook (April 2016); and OECD Outlook (December 2015); and author's calculations.

a. Middle East and North Africa includes high-income countries in the region (members of the G.C.C.) and Turkey.

b. This is equivalent to 3.2-4.5 percent for average real G.D.P. growth in 2015-2030; long-term projections are based on the following sources: The Conference Board (January 2016); The U.S. Energy Information Agency (International Energy Outlook, 2014); PwC, World in 2050 (February 2015); OECD, Looking to 2060: Long-term Global Growth Prospects (November 2012).

c. The lower bound figures are the projected average per capita G.D.P. growth in 2015-16; the upper bound figures are the projected average per capita G.D.P. growth in 2016 to 2018/20 period; projections are based on several sources, including medium-term forecasts published in the World Bank, Global Economic Prospects (January 2016); I.M.F., World Economic Outlook (October, 2015); and O.E.C.D., Outlook (December, 2015). Projections for Maghreb's G.D.P. per capita growth exclude Libya.

d. Algeria, Libya, Morocco, Tunisia.

The Potentially Disastrous Consequences of Delaying Reforms and Cooperation

Low economic growth, combined with intensifying conflict across the region, is weakening the already fragile economic structure and leading to increased poverty and youth unemployment in MENA. Ongoing conflicts created more than 9 million refugees (about 62 percent of the world's total) as of early 2016. Nearly 60 percent of them have fled from Syria to neighboring countries, imposing huge economic and social costs, particularly on Lebanon and Jordan, where refugees now account for about 25 percent of the population.

Violent conflicts have had a devastating effect on macroeconomic performance. In MENA countries that have been in conflict during the past five years, output declined by about 2.25 percentage points a year, according to recent estimates by the I.M.F.[17]

"Violent conflicts have had a devastating effect on macroeconomic performance."

As chaos and conflict spread throughout the region, defense and security expenditures in the region—already among the highest in the world—are likely to rise, just as oil revenues, tourism receipts, and worker remittances decline. Despite the drop in revenues, MENA governments are unlikely to cut back substantially on social programs or various subsidy schemes out of fear of the social and political ramifications of doing so. The result is larger fiscal and balance of payments deficits and the accumulation of debt, even in countries that traditionally maintained high levels of reserves and operate large sovereign wealth funds.

Nevertheless, the impact of the sharp decline in the price of oil on the region is likely to be significant, given large remittance and foreign aid flows, investments in infrastructure, and the banking and financial ties of the rich energy oil and gas exporters to the rest of the region.[18] Addressing these challenges, as well as security concerns and spreading violence, calls for dialogue and cooperation at the regional level rather than further increases in the region's already skyrocketing military budgets.

Military expenditure in MENA plus Turkey represented about 5.5 percent of the region's G.D.P. in 2014 (about $215 billion), a far higher share than the 2.5 percent in advanced economies or the 1.9 percent in emerging economies and developing countries as a whole. If the region's internal conflicts and tensions could be resolved diplomatically and military expenditures reduced to no more than 2.5 percent of G.D.P., the savings could be diverted to more productive and job creating domestic and regional projects.[19]

Box 1 provides the key economic issues and reform agenda the four major economic powers of the region need to consider in order to help break the vicious cycle of poor outcomes and social tension.

> **"Military expenditure in MENA plus Turkey represented about 5.5 percent of the region's G.D.P. in 2014."**

The four largest economies in the region—Saudi Arabia, Egypt, Iran, and Turkey—account for about 70 percent of the region's $4 trillion economy and are home to about 285 million of its 450 million current inhabitants. All four countries are among the 25 largest economies in the world. Their performance over the next two decades will be critical to the economic prospects of the region and the global economy.

The Urgent Need for Reforms and Regional Cooperation to Boost Growth and Create Employment

Limited integration has stifled MENA's ability to tap its significant potential for economic growth and job creation.[21] Although home to 6.5 percent of the world's population and 5.1 percent of the world's G.D.P., the region accounts for less than 2 percent of nonoil world trade (including oil and gas trade raises the figure to more than 7 percent).[22] By contrast, countries that opted for a liberal

BOX 1: REFORMS NEEDED IN SAUDI ARABIA, EGYPT, IRAN AND TURKEY

SAUDI ARABIA

Saudi Arabia's economy grew more than 5 percent a year over the past decade. The sharp drop in oil prices caused growth to slow, to about 3 percent a year in 2014-15. Depletion of the government's fiscal and balance of payments buffers has already adversely affected non-oil growth and bank balance sheets and required downward adjustments in fiscal spending. If the budget were put on a consolidation path, fiscal buffers could be used to smooth spending in the event of a temporary decline in oil prices. Targeting a positive structural balance over time would allow the accumulation of savings for future generations. The ambitious reform agenda in Vision 2030 with the overarching objective of diversifying the economy away from oil is an attempt to improve the country's performance.

EGYPT

Egypt's economy grew about 5 percent a year between 1990 and 2010, and good progress was made in the social sectors. Growth did little to reduce persistently high unemployment, however, which averaged about 10 percent during the 2000s (with youth unemployment approaching 40 percent in recent years). Although Egypt liberalized key segments of the economy in the 2000s, policies failed to ignite significant structural change, leaving the medium-term outlook uncertain. Between 2004 and 2013, growth was driven mainly by capital, followed by labor, and the contribution of T.F.P. to growth was barely positive (compared with 2-3 percentage points a year in high-performing countries in Asia). Macroeconomic adjustment and deep structural reforms are desperately needed to create conditions for higher, more sustainable, and more inclusive growth and to make public debt, which currently exceeds G.D.P., sustainable.

IRAN

The recent nuclear agreement improved Iran's economic outlook, but the medium- to long-term outlook remains highly uncertain and sensitive to Iran's domestic political situation. Most experts expect annual growth of no more than 1 percent in 2015/16, accelerating to 5-6 percent over the next three to five years—provided that Iran begins implementing badly needed reforms. The productivity shortfall is related largely to Iran's relatively low level of T.F.P. growth, a reflection of deep-seated structural problems. If Iran's economy is to grow at 6-8 percent a year on a sustained basis, T.F.P. needs to be increased substantially, through reforms, and there needs to be more efficient use of human capital, and technological upgrading of key industries. Three time bombs threaten Iran's future: vulnerability of its banking and financial sector to adverse shocks; the sustained rise in unemployment and underemployment of university graduates, and the deteriorating environment and severe water shortage.

TURKEY

Turkey has the largest, most advanced, and most diversified economy in the region (excluding Israel). Without a change in policies, Turkey's performance is likely to be weaker than in the recent past. Prudence would call for a tighter fiscal stance. In the short run, expenditure growth should be curbed. For the 2015-17 medium-term plan, the I.M.F. has recommended a cumulative fiscal adjustment of 2 percent of G.D.P. relative to its baseline. Productivity growth in Turkey contracted by 0.6 percent in 2013, after declining 0.8 percent in 2012. Underlying these estimates was a slightly better improvement in output growth than employment growth, but Turkey's T.F.P. growth continues to be negative and its labor productivity level is just 37 percent of the U.S. level. Macroeconomic policies can support rebalancing and preserve financial stability in the near-term, but improved medium-term growth will depend on progress with structural reforms that enhance Turkey's economic potential.

trade and investment regime—most notably in East Asia—have high levels of trade, employment, and per capita income.

Several economic and integration blocs include one or more MENA countries, but the region lacks an overarching cooperation and integration agreement.[23] Some schemes extend beyond the Greater Middle East.

Given the lack of economic dynamism in the region outside the G.C.C. and the low level of regional cooperation, it is not surprising that some countries have sought trade agreements outside the region. The most important are the Euro-Mediterranean agreements and a number of bilateral agreements between the United States and selected MENA countries. These agreements are useful starting points and provide a framework for cooperation, but they do not encourage competition and the development of regional value chains. Indeed, the proliferation of regional agreements has inadvertently hindered deeper integration within the region. Firms in MENA also face relatively high tariffs and restrictive nontariff measures on intermediate inputs, which prevents them from participating in global value chains.

> **“The region lacks an overarching cooperation and integration agreement.”**

Intra-MENA trade is below its potential. It represents about 9 percent of MENA’s total exports—a smaller share than nearly all other regions, and a fraction of the region’s trade with Europe and East Asia.

The region’s links to the rest of the world remain strong. Merchandise exports of MENA plus Turkey to the rest of the world exceeded $1.4 trillion in 2014, and exports of commercial services (mainly travel and transport) amounted to about $175 billion, 3.8 percent of the world total. In 2014, the region’s global share of F.D.I. outflows was 11 percent ($52 billion), and its share of workers’ remittances outflows was about 20 percent ($92 billion). About $86 billion of remittances were sent from Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates to the rest of the world. Egypt and Lebanon together received about $30 billion.

The regional schemes with the greatest potential are the Pan Arab Free Trade Area (PAFTA), which has 18 members, including all of the Arab Middle East and North Africa plus Sudan; the G.C.C.; and the Economic Cooperation Organization (ECO), founded by Iran, Pakistan, and Turkey in 1985 as a platform to discuss ways to enhance growth and development and promote trade and investment. Its current membership now includes seven Central Asian countries.[24]

A recent assessment of MENA's trade agreements concluded that trade in the region is well below its potential and the level of diversification is low.[25] It also finds that the overall impact of preferential trade agreements (P.T.A.s) has been negligible, with agreements failing to stimulate trade.[26] However, the findings also indicate that the Agadir agreement, as well as the U.S.-Jordan agreement, appear to have had a positive impact on trade, similar to the effects expected from standard P.T.A.[27] It concludes that for the regional preferential agreements to have a significant effect on trade and economic growth, they need to be deeper—involving improved governance, regulatory harmonization, labor mobility, and services trade.

> “Trade in services is a major untapped source of trade growth within the region.”

With the exception of the G.C.C., MENA's regional schemes face serious challenges, because of inadequate infrastructure, policy distortions in domestic economies, and political friction among some members.[28] The ECO may have a promising future, provided that it addresses the sub-region's formidable trade facilitation challenges and is able to act as a bridge between East Asia and MENA.

Despite commendable reform efforts in recent years, MENA continues to face binding constraints on economic competitiveness in general and trade in particular. Of critical importance is the need to improve trade-related infrastructure and strengthen trade facilitation activities. P.T.A.s within the region, though helpful in many respects, have not led to significant expansion of nonoil exports, except perhaps in Turkey, which has a dynamic and diversified export sector. The focus in MENA must therefore be on opening up to the rest of the world, which may require that individual countries aggressively pursue unilateral liberalization policies as part of their national reform programs. Trade in services is a major untapped source of trade growth within the region and between the region and the rest of the world. Regional cooperation and integration can bring benefits, but these efforts can also impose significant costs if not carried out in a manner that is compatible with broader global

BOX 2: TYPES OF REGIONAL COOPERATION AND INTEGRATION

REGIONAL ECONOMIC INTEGRATION CAN TAKE FIVE FORMS:

1. A free trade area is the most basic form of economic cooperation. Members agree to remove all barriers to trade within the area, but are free to independently determine trade policies with nonmember nations. An example is the North American Free Trade Agreement (NAFTA).
2. A customs union provides for economic cooperation as in a free trade area and removes trade barriers among members. The primary difference between a customs union and a free trade area is that members in a customs union agree to treat trade with nonmember countries in a similar manner.
3. A common market allows for the creation of economically integrated markets among member countries. It removes trade barriers and restrictions on the movement of labor and capital among members.
4. An economic union is created when countries enter into an economic agreement to both remove barriers to trade and adopt common economic policies.
5. A mega-regional trade and investment agreement, such as the Trans-Pacific Partnership (T.P.P.) and Transatlantic Trade and Investment Partnership (T.T.I.P.), which mark the first time the largest and richest countries are negotiating preferential trade agreements with one another.

LESSONS FROM REGIONAL TRADE AGREEMENTS THAT MAY BE RELEVANT FOR THE MENA REGION INCLUDE THE FOLLOWING:

- Building effective regional institutions is a difficult, lengthy, process that requires incremental, gradual, and flexible implementation with visible payoffs.
- It is preferable to keep the number of members in sub-regional and regional organizations manageable; membership should be based on shared geography and common regional interests.
- Adequate funding mechanisms for regional investments are essential.
- Successful cooperation requires leadership at the country, institutional, and individual levels.
- External assistance can be helpful in establishing and sustaining sub-regional institutions, but it cannot substitute for ownership of the process from within the region.
- Open regionalism- the creation of institutions that are open to extra-regional participation and do not discriminate against non-regional economies in the long-term-is the most successful strategy, as demonstrated in East and Southeast Asia.
- Regional economic cooperation agreements that involve ministries of finance or economy and central banks tend to be more effective than agreements that rely on the leadership of line ministries or foreign affairs.
- Transparency and the engagement of the business community and civil society strengthen the mechanisms for regional cooperation.
- Monitoring and evaluating the performance of countries under regional agreements is important, as are incentives for better compliance.

integration trends. Box 2 identifies some of the benefits and costs of regional trade agreements.

MENA leaders appear to be sensitive to calls for reform and to accelerating measures to stimulate job growth, make the economic growth process more inclusive, and foster popular participation in the development process. Political economy issues, such as resistance to reforms by groups that fear losing their favorable position to greater competition, tend to slow the pace of reforms. Economic cooperation among the major economies in the region, coupled with regional trade and investment initiatives, could help address these challenges by further boosting growth and stimulating employment. More importantly, regional cooperation could help attract the private investment needed to generate more and better jobs by removing barriers to capital inflows and creating a better enabling environment for both domestic and foreign investment.

Regional cooperation and global economic integration are complementary processes. Regional integration contributes to global integration by allowing countries to reap the benefits of geographical proximity, promoting learning by doing, and fostering efforts to build competitiveness. Global integration can place added pressure on countries to improve intra-regional integration. In many respects, regional cooperation and integration can be understood as stepping stones to wider global market cooperation, with regional infrastructure investment and trade in goods, services, and factors within MENA boosting competitiveness and encouraging the development of the institutions necessary for integration on a wider scale. While many reforms can and should be implemented unilaterally, regional cooperation is needed to bolster trade in services, create regional markets to generate scale economies, cooperate on customs and the creation of joint border posts to lower trade costs, and improve connectivity through networked infrastructure.

"Regional cooperation and global economic integration are complementary processes."

Tapping Trade Potential through Regional Cooperation and Reform

MENA is not tapping its potential for exports, because the region is not competitive in producing goods it can export to the rest of the world. To become competitive, the region needs to consider a number of reforms, including reform of trade policy. MENA countries should lower tariffs and nontariff barriers, while improving productivity growth, the business environment, and the quality and skill base of their workforces.

Diversifying Exports

MENA exports mainly primary commodities, largely oil and gas (65 percent of all exports in 2014). Manufactured goods accounted for just 21 percent of exports, with other sectors accounting for the remaining 14 percent. Exports are highly concentrated and undiversified. Egypt, Jordan, Lebanon, Morocco, and Tunisia fare better than the rest of the region on both indicators.

"Less than 7 percent of the region's exports are classified as high technology."

Although most countries have made some improvements in diversifying their exports over the past 15 years, the level of diversification remains low by international standards. Moreover, exports are generally produced with low levels of skill: less than 7 percent of the region's exports are classified as high technology, compared with about 25 percent in East Asian developing economies. This combination of limited export diversification and low-technology industry hampers productivity growth, which is already low relative to national income levels.

MENA's share of world exports of non-oil goods remained below 1 percent for years, gradually increasing over the past decade to about 2 percent in 2014. Within MENA, the U.A.E., Qatar, Kuwait, Egypt, Oman, Turkey, and Iran witnessed relatively rapid growth in non-fuel exports. Among oil importers, Egypt and Jordan made significant progress in diversifying exports. A number of countries in the region, including most G.C.C. countries, reduced their dependence on crude exports in favor of processed industrial goods, including chemicals, fertilizers, and other processed petroleum products.

Increasing Intra-regional Integration

Greater regional cooperation and economic or trade integration have been shown to yield significant economic gains to member countries. They can help alleviate shortages of energy and other resources, remove barriers to growth and job creation, and reduce prices of critical products, particularly in countries with limited access to markets. The long delay in concluding the W.T.O.'s Doha Development Agenda has been a key driver of regional trade agreements and the creation of free trade areas in the last two decades. According to the W.T.O., regional trade agreements can support the W.T.O.'s multilateral trading system. W.T.O. agreements recognize that regional arrangements and closer economic integration can benefit countries.[29]

> "In 2014, intra-regional exports of goods averaged less than 9 percent of total exports in MENA."

Most agreements and new negotiations are bilateral, although some recent negotiations involve multiple W.T.O. members. The Trans-Pacific Partnership (T.P.P.) Agreement currently involves 12 parties, which joined the massive regional partnership in the hopes of getting around the impasse on a multilateral trade agreement. Similar agreement is under consideration between the United States and the European Union under the Transatlantic Trade and Investment Partnership (T.T.I.P.), which aims to promote trade and multilateral economic growth. Except for Turkey, countries in MENA are not directly involved in either of these mega-regional agreements, but the agreements will affect them. Not having an effectively functioning regional trade agreement encompassing all four of the region's largest economies has weakened MENA's bargaining position with respect to the other regional agreements already in place or under negotiation.

Though rising, integration within the MENA region remains low, particularly compared with other middle- and high-income regions. In 2014, intra-regional exports of goods averaged less than 9 percent of total exports in MENA, compared with 59 percent in ASEAN and 63 percent in the European Union. The countries that trade the most within MENA are oil importers, led by Jordan (54 percent of total exports in 2013), Lebanon (54 percent), Egypt (33 percent), and Turkey (26 percent). Maghreb countries export within the region least (5–11 percent), with much of their exports going to Europe.

Reducing Trade Barriers

Significant progress has been made in reducing barriers to trade in goods within the region and, to some extent, between MENA and the rest of the world. Over the last decade, reductions in most favored nation tariffs complemented preferential liberalization under PAFTA and other P.T.A.s. Indeed, MENA was the region in which tariffs decreased the most during the global financial crisis, especially on manufactured goods. The average uniform tariff equivalent of all tariffs (ad valorem and specific) for the region fell from nearly 15 percent in 2002 to 5 percent in 2011.

> **"Travel and transport together made up about 80 percent of total MENA service exports in 2014."**

Wide variations in trade restrictions exist across countries and sub-regions, however. The G.C.C. has brought common external tariff down to 5 percent on most imported merchandise and to zero on essential goods, but restrictions elsewhere in the region—and in the region as a whole—remain high. According to the tariff-only Overall Trade Restrictiveness Index, only South Asia had greater tariff restrictiveness than MENA in 2011. MENA compares unfavorably with its main competitors in Europe and Central Asia, Latin America and the Caribbean, and East Asia and Pacific.

Barriers to trade and investment in services are significant: the services trade restrictiveness index, which measures the extent of barriers to trade and investment in services, is twice as high in MENA as in Europe and Central Asia.[31] Although MENA doubled its exports of services over the past decade, their share has stagnated at just 2–3 percent of total trade for the past two decades. Services exports remain dominated by tourism-related travel of low value added. Travel and transport together made up about 80 percent of total MENA service exports in 2014. This profile contrasts sharply with that of South Asia, driven by India, where information and communications technology (I.C.T.) and finance are the leading export services, making up 55 percent of service exports.

Opportunities to expand trade in services vastly exceed opportunities to expand trade in goods—and the gains could be enormous. Studies suggest that comprehensive reforms to strengthen competition and streamline regulatory frameworks would yield benefits two-to-three times greater than those achieved through tariff removal. Opening up services trade would facilitate trade in parts and components and contribute to the emergence of regional production networks.

Improving Infrastructure and Cross-Border Trade Facilitation

Trade costs constitute as much as 30 percent of the final delivered price of MENA's nonoil exports—about twice their share in Western Europe. Maghreb countries actually face lower costs trading with Europe than trading among themselves. Trade costs are high partly because backbone services, such as telecommunications, transport, and power, are not competitively priced. Opening these sectors to competition and trade would help reduce production costs, increase F.D.I., promote knowledge spillovers, and expand markets.

Trade facilitation and transport impediments impose greater losses than formal trade tariffs and quota restrictions. Logistics and trade facilitation indicators such as the Logistics Performance Index and the Liner Shipping Connectivity Index show that MENA fares better in terms of connectivity than in facilitation and logistics.[32] Although some countries, such as the U.A.E., have excellent logistics facilities, most MENA countries need to substantially improve logistics and trade facilitation to bring down the high costs of trade.

"Opportunities to expand trade in services vastly exceed opportunities to expand trade in goods—and the gains could be enormous."

Efficient ports and maritime and aviation services are crucial for the competitive export of goods. Most MENA countries have extensive road networks, modern facilities for air and sea transport, and, in many countries, well-developed rail networks. The quality of transport infrastructure is often deficient, however, unable to support growing modern economies.

> **"The infrastructure linking Arab countries to the potential growth poles in the region remain inadequate."**

Progress is being made in improving transport infrastructure. Implementation of the Mashreq Corridor Program, which aims to remove cross-border constraints, is expected to increase trade by about $25 billion a year by 2030. It will also create a large number of permanent jobs, mostly in export-oriented light manufacturing industries, which typically have a higher than average female share of employment.

Economic integration in the power sector is at an early stage of development. Major initiatives, such as the North Africa–Middle East–Europe Mediterranean Power Pool, are taking shape, though much remains to be done to introduce competition in the sector.

Considerable progress has been made in regional integration of mobile telephony, but many important cross-border issues still need to be tackled, particularly with regard to fixed and mobile broadband infrastructure. However, the infrastructure linking Arab countries to the potential growth poles in the region over the medium-term—Iran and Turkey—remain inadequate.

Effects of Preferential Trade Agreements

Over the past 15 years, there has been an unprecedented global increase in the number, breadth, and depth of P.T.A.s.[33] The number of P.T.A.s doubled during this period, to more than 250. MENA states have signed many P.T.A.s, both within the region and outside. This proliferation of P.T.A.s, with their varying sector and product coverage, rules of origin, and implementation requirements, constitutes a formidable implementation challenge for capacity-constrained institutions.

P.T.A.s have had mixed effects in MENA. They significantly reduced trade and investment barriers, provided an impetus for behind-the-border economic reforms, and helped spur trade. They also encouraged participating countries to improve their trade infrastructure, harmonize border policies and procedures, and improve their supply chains and logistics facilities. There is little evidence

"Total F.D.I. rose sharply in MENA over the past decade, but the bulk of it came from within the region."

regarding causality between P.T.A.s and policy reforms, however, as countries such as Egypt, Jordan, Morocco, and Tunisia embarked on major reforms on their own.

The P.T.A.s that MENA countries signed gave rise to a far more rapid expansion in imports than exports. The findings from a gravity panel model prepared for this study suggest that trade preferences granted to MENA countries by the United States, the European Union, and Turkey did not have an additional effect on exports compared with P.T.A.s in general, which increased trade by an average of about 21 percent. In fact, the additional effect is negative in the case of the P.T.A.s with the European Union, not significant in the case of the P.T.A.s with Turkey, and largely accounted for by Jordan's Qualifying Industrial Zone in the case of the P.T.A.s with the United States. In contrast, PAFTA and the Agadir Agreement for the Establishment of a Free Trade Zone between Egypt, Jordan, Morocco, and Tunisia expanded exports by their members, albeit from a low intra-regional trade base.[34]

There is also no evidence that P.T.A.s contributed to investment flows into the region. Total F.D.I. rose sharply in MENA over the past decade, but the bulk of it came from within the region, essentially from the G.C.C. Relatively little F.D.I. has come from the European Union or the United States.

Stepping up Policy Reforms and Political Commitment

Increasing Regional and Global Economic Integration

Regional integration and global economic integration should move hand-in-hand. There are tremendous opportunities to strengthen the linkages between MENA countries and wider and deeper global markets, including through vertical integration of global production chains.

Although progress has been made overall, albeit with wide country variations, substantial scope remains for further regional and global economic integration. To strengthen trade in goods, MENA countries could continue to unilaterally reduce their most favored nation tariffs, with an emphasis on reducing tariff peaks to the level of the most competitive regions of the world. Efforts could also be made to roll back nontariff barriers to trade, by reviewing nontariff measures, reducing their scope, and phasing out measures that are not deemed essential for national security purposes.

Strengthening Trade in Services

Reforms to strengthen trade in services include easing entry and licensing restrictions for both domestic and foreign firms in the services sectors, promoting competition, harmonizing and strengthening regulatory practices and arrangements, and lowering restrictions on the mobility of foreign workers residing in the region. Continued public ownership in the services sectors represents a potential hurdle to increased regional cooperation, given the caution with which countries of the region have moved toward privatization. Addressing these issues would have a direct impact on employment, the overriding problem in MENA, as services sectors are labor intensive and thus critical for reducing unemployment.

Reducing the Costs of Trade

MENA countries need to reduce the costs associated with trading across borders. Doing so will require improving the efficiency of border-crossing points, including the harmonization of customs procedures. Logistics systems need to be vastly improved by abolishing policies that reserve activities for specific categories of domestic firms.

"Continued public ownership in the services sectors represents a potential hurdle to increased regional cooperation."

Improving Infrastructure and Making It More Competitive

Transport networks need to be strengthened to improve the efficiency of ports and make better use of regional rail potential. In the power sector, institutional prerequisites for cross-border power trade need to be put in place alongside strategic investments in regional distribution and transmission networks. Opening up backbone telecommunications infrastructure to competition and encouraging inward investment in broadband services could bring I.C.T. costs down and make Internet services more readily available. This broad reform agenda needs to be tailored to each country's circumstances, binding constraints on development and growth, and stage of reform.

Setting Regional and Intra-regional Priorities

Strong political commitment and leadership will be required if regional economic cooperation and integration are to make meaningful contributions to growth and employment in MENA. It is critical that Iran be admitted to the W.T.O., a focal point for much needed economic reforms and better governance. Its admission would lead to improved trade competitiveness through the reduction of uncertainty and related risk perceptions, allowing Iran to also play an active role in intra-regional trade and in setting the region's trade policy agenda. The ongoing political change sweeping through the Arab world, combined with the Iran nuclear deal, provide an extraordinary opportunity for the region to accelerate economic integration efforts.

> "It is critical that Iran be admitted to the W.T.O."

The G.C.C. has made substantial progress in reducing tariffs and nontariff measures and improving trade logistics and infrastructure, but reforms are needed in services. In the Mashreq countries, which have strong links to the G.C.C., good infrastructure and cross-border trade facilitation should be prioritized. In the Maghreb, which has strong links to the European Union, reducing tariffs and nontariff measures and improving cross-border trade facilitation should be high on the reform agenda.

What Should Be Done? Policy Recommendations

Analysis of conditions in the region as well as regional and global megatrends yields several recommendations for MENA.

Adopt a Four-Pronged Strategy

For each of the major players in the region, a strategy could include four prongs:

1. Reduce regional tensions and end conflicts through diplomacy , recognizing that current approaches are impeding investment and economic growth, and will result in lose-lose outcomes.
2. Undertake significant economic and institutional reforms at home to remove binding constraints on growth and development, particularly in manufacturing and services; reform the banking and financial sector and improve access to funds by the private sector and citizens; and improve the quality of education.
3. Focus on well-targeted policies and structural reforms that would lead to significant reductions in youth unemployment and increased female labor force participation, introduce cuts in military expenditures as regional tensions subside, and reallocate the savings to clean energy and infrastructure investments to crowd in private investment and boost growth.
4. Increase cooperation and trade, both within the region and with major global growth poles. Initiate regional projects (in partnership with the private sector) with high payoffs for all countries in the region and their citizens—in areas such as tourism, air and ground transport, regional energy and water, regional health and education, and research hubs—to increase trade in goods and services (within the region and globally), build confidence and good will, and create positive spillover effects within the region over the medium term.

Taken together, these country-based reforms and regional initiatives could boost the region's long-term growth potential from the 3.0–4.5 percent a year range to the 5–8 percent a year range, similar to the performance of developing countries in Asia. Significant contributions would come from the more efficient use of factor inputs, particularly human capital with improved skills, and technological progress, in the form of more rapid growth of total factor productivity, which has been low and declining in all major economies of the region.

Craft and Implement Significant National-Level Reforms

National reforms to boost inclusive and sustainable growth, through increases in investments and acceleration of total factor productivity growth, would likely involve the following measures:

- Adopt a bold economic reform agenda to propel private sector activity and foster a more dynamic, competitive, innovation-driven, and inclusive economy. To achieve broad-based and sustainable growth, countries need to gradually move away from state-dominated to private investment, from protected and rent-seeking enterprises to export-led growth and value creation.

- Craft policies that improve the business climate, revive private sector confidence, and lay the foundations for higher growth. Gradually transform the public sector from a system that provides privileges—public employment, subsidies, economic rents, tax exemptions—to one that provides basic economic services, adequate social protection, better governance, a level playing field for all economic actors, and a competitive environment for the private sector.

- Deepen trade integration. In addition to the large potential direct gains of boosting exports and attracting productivity-enhancing F.D.I., trade integration can catalyze reforms in other areas that help countries compete. Deeper trade integration will require better access to markets in advanced economies,

> **"These country-based reforms and regional initiatives could boost the region's long-term growth potential to the 5–8 percent a year range."**

"Countries need to gradually move away from state-dominated to private investment."

reductions in tariffs and nontariff trade barriers, and a focus on the increasingly important areas of trade facilitation and export promotion.

- Simplify complex and burdensome business regulation in order to unleash entrepreneurial activity and private investment. Reforms must streamline business regulation, reduce the scope for discretion, increase transparency, and strengthen institutional autonomy and accountability.

- Adopt labor market reforms that provide incentives for hiring and boost employment in the formal private sector labor market, and eliminate regulations that discourage hiring women.

- Create social safety nets that protect the poor in cost-effective ways. To transition from costly generalized subsidies to targeted forms of social protection, consolidate and increase spending on existing safety net programs and improve their coverage; prioritize interventions that strengthen human capital (such as conditional cash transfers); invest in social safety net infrastructure, such as unified registries for beneficiaries; increase the use of modern targeting techniques; strengthen governance and accountability; and increase communication to potential beneficiaries about the programs available to them.

Complex political processes, the increasing polarization of society, and a difficult security environment make policymaking challenging. To set in motion a virtuous circle in which political transition and economic transformation reinforce one another, policymakers need to adopt a participatory approach, engage with different segments of society, and build coalitions for reform.

Set Policy Priorities to Enhance the Chances of Achieving a Best-Case Outcome by 2030

The following actions in each country in the region would enhance the chances of the best-case scenario materializing:

- Invest in citizens. Equip them with the tools to seize opportunities through high-quality training and education, and protect the most vulnerable.

- Prepare for a new, sustainable, and inclusive growth paradigm, by investing in early childhood health and education and improving living conditions of ethnic groups and minorities.

- Enable the private sector to invest, reap economic opportunities, compete globally, and create productive jobs, particularly for youth.

- Encourage the education of girls and increase the participation of women in the labor force.

- Focus on the well-being of citizens by strengthening health, social services, and the social safety net.

- Undertake labor market and education reforms.

- Reinvent government. Recalibrate the public sector to accommodate the realities of the 21st century.

- Protect the environment. Remove energy subsidies, invest in clean energy, protect water supplies, and use energy and water efficiently.

- Undertake major regional infrastructure projects in energy, water, and transport (ground and air transport) to substantially improve links among the major countries in the region.[35]

- Deepen trade integration within the region and with the rest of the world. Doing so could yield large direct gains from higher exports and productivity-enhancing F.D.I., and catalyze reforms in other areas that help countries compete.

Launch a Mini–Marshall Plan

Such a plan should include a commitment to coordinate a high-level economic commission involving the World Bank, the International Monetary Fund, the United Nations and its specialized agencies, and other relevant international and regional development agencies. These bodies would work with MENA governments in a coordinated way to craft a multi-year, regional development agenda that would involve funds not only for reconstruction and the resettlement of millions of refugees, but also for regional projects. The European Recovery Program—the original Marshall Plan—involved about $150 billion in today's prices, spent over a four-year period (about 1.5 percent of America's G.D.P. a year between 1948 and 1951). A MENA recovery program must be on a similar scale if it is to achieve the desired outcomes.

In order to raise the region's growth and make a real dent in its extremely high youth unemployment rates (approaching 30 percent), the private sector needs to be revitalized, particularly in Egypt and Iran. Instruments like the Catalytic Finance Initiative and related funds by the International Finance Corporation, with participation of the private sector, governments of advanced and emerging economies, as well as strategic investments by the sovereign wealth funds of the G.C.C. countries, should therefore be integrated into this mini–Marshall Plan.

"Regional economic powers should consider creating an infrastructure and development bank for MENA."

The regional economic powers, together with the international community, should also consider creating an infrastructure and development bank for MENA, which would provide long-term financing for regional projects as well as major country-level projects with positive regional spillover effects. Such projects, which could be co-financed by the private sector and follow the public-private participation model, should be conceived and undertaken only in countries that implement major domestic reforms along the lines outlined above. The reforms are the sine qua non for achieving the desired growth and job creation in each country and reaping the complementary growth effects from increased economic integration, both within the region and internationally.

Endnotes

1. As a result of the substantial drop (about 60 percent) in the price of oil in 2014-2015, the major oil exporters in the region, particularly the G.C.C. members, are facing large budget and current account deficits for the first time in many years. The region's fuel exporters' budget balances shifted sharply from an average surplus of more than 5 percent of G.D.P. in 2008-13 to projected deficits in excess of 12 percent of G.D.P. in 2015-16. The shift was even more pronounced for the G.C.C., whose combined budget shifted from a surplus of about 11 percent of G.D.P. in 2008-13 into projected deficits of about 13 percent of G.D.P. in 2015-16. Similarly, the combined current account balance of payments of the region's oil and gas exporters shifted from an average surplus of about 14 percent of G.D.P. (or about $390 billion a year) in 2008-13 into projected deficits of about 4 percent of G.D.P. (or about $90 billion a year) in 2015-16. Official reserves have already declined in a number of major fuel exporting countries, e.g. Saudi Arabia alone reduced its official reserves by an estimated $100 billion by end-2015, and is expected to resort to further borrowing from international capital markets in 2016 to protect its reserves. Moreover, total assets of Sovereign Wealth Funds (S.W.F.) funded by oil and gas have declined by nearly 10 percent (about $400 billion) since 2014. The decline in S.W.F. assets has been particularly pronounced in Saudi Arabia while some of the other G.C.C. members have continued to accumulate assets, but even these countries, such as the U.A.E., Kuwait and Qatar, which have small populations and relatively large international reserves and S.W.F. and are better able to weather the sharp declines in the prices of oil and gas, have had to reduce public spending and rollback subsidies to protect their fiscal buffers. A recent estimate by I.M.F. staff indicates that based on rough calculations, prior to the oil price decline, the G.C.C. countries were projected to have a combined fiscal surplus of about $200 billion in 2015-2020, but are now are expected to have a combined fiscal deficit of about $450 billion during the same period, a turn-around of about $650 billion in the projected change in net assets with important economic and financial implications for the region and the global economy. See Rabah Arezki, Adnan Mazarei, Ananthakrishnan Prasad, "Sovereign Wealth Funds in the new era of oil," Vox (2015), accessed May 19, 2016, http://www.voxeu.org/article/sovereign-wealth-funds-new-era-oil.
2. Measured by G.D.P. in 2014 in US dollars in purchasing parity prices (PPP), Saudi Arabia was the 14th largest economy in the world, followed by Turkey (17th), Iran (18th), and Egypt (22nd). In terms of 2015 population size, Egypt ranked 15th in the world, Iran 17th, Turkey 18th, and Saudi Arabia 46th.
3. Ross Harrison, "Defying Gravity: Working toward a Regional Strategy for a Stable Middle East," Middle East Institute (2015), accessed May 19, 2016, http://www.mei.edu/content/article/defying-gravity-working-toward-regional-strategy-stable-middle-east; and Ross Harrison and Shahrokh Fardoust, "Time for a U.S. Regional Strategy for the Middle East," National Interest, May 25, 2014, accessed May 19, 2016, http://nationalinterest.org/feature/time-us-regional-strategy-the-middle-east-10528.
4. The literature on international cooperation analyzes situations and strategic settings where all out war among states is considered to be too costly as an option. However, the quality of "peace" (i.e. no "all out war") can differ substantially depending on the strategies the concerned states pursue and the level of cooperation they are willing to work toward and ultimately attain. It turns out that the more states care about future payoffs (benefits that might accrue to each state in the absence of conflict), the easier cooperation is to achieve. This is because the more states value future, the less willing they are to pursue policies or actions that

may result in short-term gains at the cost of long-term benefits that may accrue to them through improved relationships and cooperation. See Andrew H. Kydd, International Relations Theory: The Game-Theoretic Approach (Cambridge: Cambridge University Press, 2014).

5. Hedi Larbi, "Connecting Countries to Stabilize the Middle East," The Middle East Institute 4 (2016), accessed June 8, 2016, http://www.mei.edu/sites/default/files/publications/PP4_Larbi_RCS_Infrastructure_web.pdf.

6. "World Economic Outlook Update," IMF (2016), accessed May 19, 2016, http://www.imf.org/external/pubs/ft/weo/2016/update/01/pdf/0116.pdf; and Ayhan Kose, Franziska Ohnsorg, and Kaushik Basu, Global Economic Prospects: Spillovers amid Weak Growth (Washington D.C.: International Bank for Reconstruction and Development / The World Bank, 2016) accessed May 19, 2016, http://pubdocs.worldbank.org/pubdocs/publicdoc/2016/1/697191452035053704/Global-Economic-Prospects-January-2016-Spillovers-amid-weak-growth.pdf.

7. Several recent studies provide in-depth analysis of labor market/employment issues in MENA. In most countries in the region, the main job problem is insufficient economic growth and, particularly in oil-importing countries, lack of job creation. Recent estimates indicate that the current pace of annual economic growth (about 2–3 percent) will have to increase to at least 6 percent during the next two decades to address the region's unemployment problem, given the region's rapidly growing labor force and the high desirability of raising female labor force participation rate, which are currently among the lowest in the world. Faster growth is necessary but not sufficient for well- paying jobs in the formal sector, however. Doing so will require improving the quality of education; increasing access to skills building/upgrading programs; and substantially improving the business environment to enable firms to compete and innovate. Countries will need to reduce regulatory barriers, particularly against female workers, in labor markets and remove distortions that discourage labor-intensive activities in all sectors of the economy. For more detailed discussion of these issues, including major structural differences between oil exporters and importers in the region, as well as sectoral differences in the size of employment creation elasticity with respect to the overall economic growth and sectoral activities, particularly infrastructure, see Antonio Estache, Elena Ianchovichina, Robert Bacon, and Ilhem Salamonm, Infrastructure and Employment Creation in the Middle East and North Africa (Washington D.C.: World Bank, 2013), accessed May 19, 2016, https://openknowledge.worldbank.org/bitstream/handle/10986/12237/NonAsciiFileName0.pdf?sequence; and for detailed policy discussion of the implications of changes since the Arab Spring for the labor markets in MENA see Roberta Gatti et al., Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa (Washington D.C.: World Bank, 2013), accessed May 19, 2016, https://openknowledge.worldbank.org/handle/10986/13284, and Marc Schiffbauer, Abdoulaye Sy, Sahar Hussain, Hania Sahnoun, and Philip Keefer, Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa (Washington D.C.: World Bank, 2015), accessed May 19, 2016, https://openknowledge.worldbank.org/handle/10986/20591.

8. For a detailed analysis of major global economic, social, and environmental issues over the long term and their policy implications at the national and international levels, see Franklin Allen, Jere R. Behrman, Nancy Birdsall, Shahrokh Fardoust, Dani Rodrik, Andrew Steer, and Arvind Subramanian, eds., Towards a Better Global Economy: Policy Implications for Citizens Worldwide in the 21st Century (Oxford: Oxford University Press, 2014),

accessed May 19, 2016, https://global.oup.com/academic/product/towards-a-better-global-economy-9780198723455?cc=us&lang=en&.

9. For a summary of research on long-term economic growth in advanced and developing countries, see Jere Behrman and Shahrokh Fardoust, "Towards a Better Global Economy Project: Overview and Policy Options," in Franklin Allen, et al., eds, Towards a Better Global Economy. Long-term projections of economic growth generally assume no major macroeconomic and financial crisis over the projection time horizon. They also assume away major climate change, war, or regional conflict–induced disasters with global consequences. While these assumptions may result in optimistic projections, such projections do not incorporate substantial changes that could occur as a result of possible policy changes that may result in deeper structural reforms which may in turn result in significant acceleration of growth in future. In general, however, the pace of growth is expected to gradually slowdown in all global regions over the next two to three decades, largely as a result of the convergence effect (technology catch-up) and aging of populations in a number of large economies. Based on this approach, the projected slowdown of average growth of trend G.D.P. in the period to 2030 (in comparison to average trend growth rate of trend output in the previous two decades) is about 0.5 percent per annum in advanced economies and o.8 to 1 percent per annum in developing countries.

10. Trade by the region's oil exporters accounts for more than three-quarters of the trade to output ratio in MENA. With the sharp declines in oil prices in the past year, this ratio is likely to fall significantly, particularly if lower oil prices persist and the governments in these countries are forced to cut back on their imports and public spending.

11. For a recent report by the World Resources Institute, see Andrew Maddocks, Robert Samuel Young, and Paul Reig, "Ranking the World's Most Water-Stressed Countries in 2040," World Resources Institute, August 26, 2015, accessed May 19, 2016, http://www.wri.org/blog/2015/08/ranking-world%E2%80%99s-most-water-stressed-countries-2040.

12. See Nancy Birdsall with Christian Meyer and Alexis Sowa, "Global Markets, Global Citizens, and Global Governance in the 21st Century" (Working Paper 329, Center for Global Development and the Global Citizen Foundation: Washington D.C., 2013), accessed May 19, 2016, http://www.cgdev.org/sites/default/files/Birsdall_Meyer_Sowa_global-citizens-for-layout_wcvr_1.pdf.

13. Monika Aring, "Report on Skill Gaps" (UNESCO and EFAGMRL: Paris, 2012), accessed May 19, 2016, http://unesdoc.unesco.org/images/0021/002178/217874e.pdf.

14. A recent assessment by the World Bank indicates that while most countries in the MENA region have had impressive achievements in terms of school enrollment rates and increased literacy, for a significant portion of students across the region "schooling has not been synonymous with learning." See "Education in the Middle East and North Africa," The World Bank, January 27, 2014, accessed May 19, 2016, http://www.worldbank.org/en/region/mena/brief/education-in-mena; and Jere Behrman and Nancy Birdsall, "Information, Assessment and the Quality of Education around the World in a Changing Global Labor Market: Making More People Winners," Global Citizen Foundation (2015), accessed May 19, 2016, http://www.gcf.ch/wp-content/uploads/2016/01/Behrman_Birsdsall-Information-Assessment-and-the-Quality-of-Education.pdf.

15. David Cuberes and Marc Teignier, "Gender Gaps in the Labor Market and Aggregate Productivity," University of Sheffield (2012), accessed May 19, 2016, http://www.sheffield.ac.uk/polopoly_fs/1.186609!/file/serps_2012017.pdf.

16. For a discussion of arguments put forward by Thomas Piketty on inequality in the Middle East see: Jim Tankersley, "This Might be the Most Controversial Theory for What's Behind the Rise of ISIS," Washington Post, November 30, 2015, accessed May 19, 2016, https://www.washingtonpost.com/news/wonk/wp/2015/11/30/why-inequality-is-to-blame-for-the-rise-of-the-islamic-state/; on the other hand, a World Bank report on this topic concludes that growing and broadly shared dissatisfaction with the quality of life (based in perception surveys) were the main reasons for the uprisings during the so called Arab Spring. According to this report, the middle classes "were frustrated by their deteriorating standards of living due to a lack of job opportunities in the formal sector, poor quality public services, and the lack of government accountability." See Lili Mottaghi, Elena Ianchovichina, and Farrukh Iqbal, Inequality, Uprisings, and Conflict in the Arab World (Washington D.C.: International Bank for Reconstruction and Development / The World Bank, 2015), accessed May 19, 2016, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/10/13/090224b0831415a3/3_0/Rendered/PDF/Inequality00up0ct0in0the0Arab0World.pdf.
17. Aasim Husain, Natalia Tamirisa, and Martin Sommer, Regional Economic Outlook: The Middle East (Washington, DC: International Monetary Fund, 2015), accessed May 19, 2016, https://www.imf.org/external/pubs/ft/reo/2015/mcd/eng/pdf/menap1015.pdf. According to the report, countries in MENA that were in conflict during 2011–15 suffered an average output decline of 2.25 percentage points a year as a result. Countries that did not experience conflict but had neighbors that did also tended to have lower G.D.P. growth. Conflicts also increased inflation and reduced foreign direct investment inflows.
18. For a discussion of spillovers effects in the region, see Regional Integration and Spillovers: Middle East and North Africa (Washington D.C.: World Bank, 2016), pp 132-176, accessed May 19, 2016, https://www.worldbank.org/content/dam/Worldbank/GEP/GEP2016a/Global-Economic-Prospects-January-2016-Spillovers-MENA.pdf.
19. The size of the peace dividend will depend on a multitude of factors. Ending a conflict is highly beneficial, because peace ends further destruction. But significant and sustained benefits require a reduction in military expenditures and their reallocation on reconstruction and humanitarian needs of the affected population and in projects with high economic and social returns (resulting in growth and job creation). To ensure sustained and sizeable peace dividend, the concerned countries need to reform their economies and institutions and also invest in the region's stability through greater cooperation and economic cooperation (as done in Europe and East Asia after World War II). For a thoughtful, albeit somewhat dated, analysis of the potential peace dividend in the Middle East, see Stanley Fischer, Dani Rodrik, and Elias Tuma, The Economics of Middle East Peace (Cambridge: MIT Press, 1993); see also I.M.F. report cited in a footnote above on the estimated effects of conflicts of the last five years on economic growth of the MENA region. A recent World Bank report on the economic effects of war and peace in MENA argues that an end to the civil wars "will improve macroeconomic indicators through restoring security, increase in investment, and reconstruction activity. Social indicators will also improve as public resources that were used for military expenses could be shifted to education and health. But the pace and pattern of economic recovery in the short term is typically not smooth, as post-conflict countries inherit a weak economy, damaged physical, human and social capital, widespread poverty and high unemployment particularly among youth." MENA Quarterly Economic Brief, January 2016: The

Economic Effects of War and Peace, (Washington D.C.: World Bank, 2016), accessed May 19, 2016, http://www.worldbank.org/en/region/mena/publication/mena-quarterly-economic-brief-january-2016.

20. Zubair Iqbal, "Iran's Post-Sanctions Economic Options," The Middle East Institute 11 (2016), accessed May 19, 2016, http://www.mei.edu/sites/default/files/publications/PF11_Iqbal_IranPostSanctions_1.pdf.

21. Bernard Hoekman, "Intra-Regional Trade: Potential Catalyst for Growth in the Middle East," The Middle East Institute (2016), accessed May 19, 2016, http://www.mei.edu/sites/default/files/publications/Hoekman_PDF%20%282%29.pdf

22. Ibid.

23. For a brief explanation of regional trade agreements and lessons of experience, see Box 2 in the main text.

24. In addition to Iran, Pakistan, and Turkey, the ECO includes Afghanistan, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. The aggregate G.D.P. of ECO members was $4.7 trillion in 2014, and its population was 420 million.

25. The assessment included the following agreements: EU-MENA FTA (Algeria, Egypt, Jordan, Lebanon, Morocco, Palestinian Authority, Syria and Tunisia); US-MENA P.T.A. and US-Israel FTA (Jordan, Morocco, Bahrain, Oman, Israel, and Lebanon); Turkey-MENA FTA (Egypt, Morocco, Palestinian Authority, Syria, and Tunisia); PAFTA; and Agadir Agreement (Egypt, Jordan, Morocco, and Tunisia)

26. For an assessment based on gravity- modeling see Caroline Freund and Alberto Portugal-Perez, "Assessing MENA's Trade Agreements," in The Arab Spring: Implications for Economic Integration, Michael Gasiorek, ed. (London: Centre for Economic Research, 2013).

27. Agadir Agreement for the establishment of a free trade zone between Arabic Mediterranean countries (Egypt, Jordan, Morocco, and Tunisia) came into force in 2007.

28. For an informative analysis of the history of cooperation in the MENA region see Paul Salem, "Building Cooperation in the Eastern Middle East," Carnegie Endowment for International Peace 24 (2010).

29. In the W.T.O.'s publicly available assessment, regional agreements have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally. Some of these rules paved the way for agreement in the W.T.O. Services, intellectual property, environmental standards, and investment and competition policies are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion by the W.T.O. The groupings that are important for the W.T.O. are those that abolish or reduce barriers on trade within the group. However, the W.T.O. recognizes that under certain circumstances, RTAs can hurt the trade interests of other countries. According to the W.T.O., under normal circumstances, setting up a customs union or free trade area would violate the W.T.O.'s principle of equal treatment for all trading partners (most-favored nation). But GATT's Article 24 allows regional trading arrangements to be set up as a special exception, provided certain strict criteria are met. W.T.O. members are bound to the RTAs in which they participate. As of 2015, nearly all W.T.O. members had notified the W.T.O. of their participation in one or more RTAs (some countries are party to many RTAs, leading to a "spaghetti bowl," which could cause distortions). Since the creation of the W.T.O., in 1995, more than 400 arrangements covering trade in goods or services have been notified (124 were created between 1948 and 1994).

30. "Facts and Figures on Regional Trade Agreement,"

World Trade Organization, accessed May 19, 2016, https://www.wto.org/english/tratop_e/region_e/regfac_e.htm; and Joannes Linn, "Central Asian Regional Integration and Cooperation: Reality or Mirage?" in The Economics of the Post-Soviet Eurasian Economic Integration (Washington D.C.: Brookings, 2012), accessed May 19, 2016, http://www.brookings.edu/~/media/research/files/papers/2012/10/regional-integration-and-cooperation-linn/10-regional-integration-and-cooperation-linn.pdf.

31. See Hoekman, "Regional Integration".
32. Ibid. According to recent data, the LPI for Tunisia and the United Arab Emirates has deteriorated somewhat.
33. P.T.A. are in effect in all regions. Bilateral P.T.A. are becoming the norm, often between countries in different regions. South-South P.T.A. represent about two-thirds of all P.T.A., and North-South P.T.A. about one-quarter.
34. Rules of origin exist in P.T.A. to preserve the value of preferences accorded to PTA members when they maintain different external tariffs. The ways in which they are calculated in different P.T.A. can inadvertently impede trade. Typically, PTA members define a percentage of the value added that must originate in another PTA member for the product to be deemed eligible for preferential tariff treatment. Rules of origin prevent products from entering the member country with lower external tariffs for transshipment to another PTA member that maintains higher tariffs against the third country's goods. As a result, the rules of origin penalize regional producers by forcing them to source from less efficient suppliers located within the region.
35. In a new strategy for MENA, the World Bank has proposed regional projects in energy, water, and education. It estimates the costs of meeting Libya's infrastructure needs at about $200 billion, rebuilding war-torn Syria at about $170 billion, and meeting Yemen's humanitarian needs at $274 million over the next 10 years. According to its estimates, the conflict with ISIS in the Levant will have cost the region about $35 billion in lost output over this period. The region's massive refugee problem, the biggest since World War II, will have additional financial implications that will be massive; see "Our New Strategy," The World Bank, November 5, 2015, accessed May 19, 2016, http://www.worldbank.org/en/region/mena/brief/our-new-strategy.

About the Author

Shahrokh Fardoust is a research professor at the Institute of the Theory and Practice of International Relations at the College of William and Mary. His previous positions include Director of Strategy and Operations, Development Economics at the World Bank and Senior Economic Adviser to the Senior Vice President and Chief Economist at the World Bank. Dr. Fardoust obtained his PhD in economics from the University of Pennsylvania. He has authored numerous papers and reports on development policy. He is a co-editor of *Post Crisis Growth and Development: A Development Agenda for the G20* (World Bank, 2011) and *Towards a Better Global Economy: Policy Implications for Global Citizens Worldwide in the 21st Century* (Oxford University Press, 2014). He is also a member of the SovereigNET Advisory Council at the Fletcher School at Tufts University.

About the Middle East Institute

Founded in 1946, the Middle East Institute is the oldest Washington-based institution dedicated solely to the study of the Middle East. Its founders, scholar George Camp Keiser and former U.S. Secretary of State Christian Herter, laid out a simple mandate: "to increase knowledge of the Middle East among the citizens of the United States and to promote a better understanding between the people of these two areas."

MEI's work is driven by its roster of scholars, comprised of former U.S. ambassadors, government officials, and top analysts who write and appear regularly in the U.S. and international media. MEI reaches a global audience through its website via event videos and podcasts, social media outlets including Twitter and Facebook, and *The Middle East Journal*, the longest running peer reviewed journal in the United States devoted to the study of the region.

MEI has earned a reputation as an unbiased source of information and analysis on this critical region of the world, a reputation it has meticulously safeguarded since its creation. Today, MEI remains a respected, non-partisan voice in the field of Middle East studies.