Executive Summary

The combination of a Covid-19 pandemic and a collapse in oil prices has affected all aspects of the economies in the Middle East and North Africa (MENA). The region’s economies are projected to contract by 5.2 percent in 2020, which is 4.1 percentage points below the forecast in April 2020, and 7.8 percentage points worse than that of October 2019, reflecting an increasingly pessimistic outlook for the regional economy. The region is expected to recover only partially in 2021.

The outlook for MENA’s current account and fiscal balances also deteriorated sharply. Driven largely by lower oil export revenue, a drop in fiscal revenue, and the large increase in fiscal expenditure required to respond to the health crisis, the region’s current account and fiscal balances in 2020 are forecast at -4.8 percent and -10.1 percent of GDP respectively, much worse than the forecasts in October 2019. Public debt is projected to rise significantly in the next few years, from about 45 percent of GDP in 2019 to 58 percent in 2022.

The forecasts are fluid and uncertain. The 2020 growth outlook for the region steadily deteriorated as more information became available—reflecting forecasters’ increasingly pessimistic view of the cost of the crisis. The great uncertainty in the outlook is reflected in disagreements among the forecasters. Because of the uncertainty related to the dual pandemic and oil-price shock, high-frequency data assumes an important role in tracking economic activity. High-frequency data for the MENA region as of August indicate that economic activities are stabilizing but at a much lower level than in December 2019.

The pandemic has profoundly affected livelihoods and is causing many citizens in the region to fall deeper into poverty. Early evidence from World Bank phone surveys indicates that the pandemic has disproportionately affected the poor. Poorer households are more likely to be self-employed or work in the informal sector, both areas that have been more affected by the pandemic. As a result, poorer people are more likely to have lost their incomes. The financial situation of poor households is deteriorating rapidly.

Governments in the region have reacted by spending more on social protection. The size and type of support vary by country, with many offering cash transfers. Some are reasonably well targeted, although a large fraction of cash transfers meant for the poor continues to leak to better-off households.

Despite various transfer programs and other coping mechanisms, many households are experiencing a significant decline in their purchasing power. This decline translates into increased poverty and food insecurity. The poorest households are affected most, as data from Tunisia demonstrate. Tunisian households in the poorest quintile are about five times more likely to have reduced their food consumption than households in the top wealth quintile.

In dealing with the Covid-19 pandemic, the top priority is responding to the health crisis while aiming to preserve consumption and production capabilities. If financially feasible, countries should postpone fiscal consolidation until recovery is well underway. Reallocating spending to deal with the immediate impacts of the crisis and making such spending more efficient, for example, by proactively reducing leakages to ensure relief measures reach the intended beneficiaries can help create fiscal space. In the medium run, there is a strong need to boost productivity to restore growth and stabilize the debt. A powerful way to do that would be to pursue profound institutional reforms that would reshape the role of the state, promote fair competition, accelerate the adoption digital technology, and pursue regional integration, which is the focus of this report.
Trade openness can be significant in achieving inclusiveness, provided trade reforms are implemented that are complemented with inclusive growth strategies. Together with complementary sector policies, trade can contribute to lower poverty and empower poor and marginalized groups—mainly youth and women. MENA’s trade integration, within the region and with the rest of the world, remains below expectations, for reasons both economic and political. They include the exclusion of agricultural goods and services from association agreements with the European Union, as well as the persistence of high non-tariff trade costs. The low levels of integration among MENA countries are due in part to insufficient reforms of the legal frameworks for investments and lack of convergence of regulations on non-tariff measures (NTMs). Political cooperation has also proven to be problematic, while conflicts and violence also hinder trade and deter economic growth and its potential for inclusiveness.

The business environment and logistics, both important facilitators of trade, impede MENA’s integration into regional and global value chains. Despite recent improvements, the MENA region underperforms in access to credit, which is lower than anywhere else in the world. Meanwhile, trading across borders is expensive and time-consuming—it costs, on average, US$442 to comply with border requirements for exporting and takes 53 hours, which is three times more expensive and four times longer than the averages among OECD high-income economies. The lack of a modern insolvency framework, the unpredictability of enforcement, and insufficient labor mobility are also important obstacles to integration. The region also is among the most restrictive regarding trade in services.

The Covid-19 pandemic offers an opportunity for MENA countries to rethink social and economic policies aimed at strengthening trade integration while reducing oil dependency. To stimulate job creation, make economic growth inclusive, and ensure stability in MENA, a new trade integration framework is being proposed—that goes beyond tariff reductions and links trade to sectoral reforms and public goods provision to promote inclusion and reduce possible disparities associated with trade liberalization. To succeed, a coordinated MENA trade integration agenda is necessary to facilitate regional value chains (RVC) and better integration into global value chains (GVC). That agenda is also designed to attract quality investments for a diversified, inclusive, and sustainable regional development strategy. This agenda favors cross-sectoral approaches first. The creation of a common MENA regional digital market could be among them. MENA can improve its digital connectivity with markets in Africa and European countries to increase productivity, coordinate efficient disaster response, thus creating inclusive growth, resiliency and jobs in the region. Supporting regional connectivity, developing sub-regional infrastructure, and expanding digital trade entail the adoption of new technologies and the provision of “digital public goods,” including fast and reliable broadband internet and digital payment solutions. Regional approaches in enhancing skills and strengthening statistical capacity are needed to allow countries to obtain scale benefits and undertake specialization and build comparative advantages—which could be a positive trigger for deepening integration.

Meanwhile, sector integration can proceed in a coordinated manner. Because the global disruptions caused by the pandemic affect multinational enterprises’ decisions about restructuring the geographic and industry scope of their supply chains, policies that enable the region to adjust to possible reconfigurations of value chains are desirable. For example, Morocco and Tunisia (for electrical machinery), Saudi Arabia (for chemicals), and the UAE (for metal and metal products) should be prepared to respond to disruptions of China’s exports of intermediate inputs. MENA countries can capitalize on the re-shoring and near-shoring trends in GVCs, that are bringing intermediate input production activities closer to the three main trading regions (European Union, Asia and the Pacific, and North America). The EU’s proximity makes it a promising export market for MENA businesses. Post-Covid trade can be driven by sectors that are most sustainable and resilient to economic shocks, and that present an opportunity for MENA’s immediate recovery and medium-term transformation. They include health services, food security, and the knowledge economy. Tariffs on essential medical products can be reduced, which could offer predictability on availability of key supplies. In addition, for some MENA countries—such as Jordan, where the pharmaceuticals sector has been a “rising star”—this new focus could create immediate opportunities for regional trade integration. Meanwhile, labor mobility within the

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region, particularly through trade in services, can be promoted to facilitate human capital enhancement and skills adaptation. Here, European policies can also help. Talks on a mobility partnership that would further facilitate legal migration to Europe for MENA businesspeople, students, and young workers can be revived. Although negotiations are challenging, such partnership would significantly stimulate trade in goods and services.

MENA’s intraregional integration should lead to increased trade flows with European and sub-Saharan African partners. The time is right to revise regional mechanisms for strategic cooperation, particularly in the context of existing trade liberalization agreements. The African Continental Free Trade Area (AfCFTA) offers an opportunity for MENA and sub-Saharan Africa to simplify and harmonize their non-tariff measures—especially the restrictive export-related measures and technical barriers. Real income gains from full implementation of the AfCFTA have been conservatively estimated at 7 percent by 2035. MENA countries directly participating in the AfCFTA, such as Morocco, Egypt and Tunisia, could each gain around 5 percent.

Meanwhile, there are opportunities for cooperation in an EU-MENA-Africa axis. The shift of specific MENA countries toward their African neighbors should be continued, and merits increased attention from the European Union. Trade ties between Maghreb countries and countries in the Sahel and West Africa could help promote stability and support African economic integration—a goal in the EU guidelines for a new EU-Africa strategy. Better infrastructure links between North African countries and the rest of the continent would contribute to the integration agenda.

MENA countries can cooperate on trade within the region and on the broader rules-based multilateral systems. Trade reforms can be “intelligent” by taking into account not only specific technical matters but also political economy considerations, in order to increase regional cooperation and stability. The effectiveness of policies will depend on the role of regional institutions, as well as the involvement of small- and medium-sized enterprises and civil society in decision-making processes.

Overall, leveraging regional integration to enable domestic reforms as a steppingstone to enhance global integration could become a new source of growth, jobs, and stability in the MENA region. To succeed, a new MENA trade integration framework would include the following pillars:

- A balance between political and economic objectives to ensure agreements do not fail.
- Trade liberalization that benefits all sectors, including agriculture and services, with reforms that cover all regulatory areas of mutual interest, including trade facilitation, standards and conformity assessment, investment protection, government procurement, and competition policy.
- Simultaneous behind-the-border reforms pursued with closer collaboration within MENA, but also with Europe and Africa.
- An emphasis on advancing the private sector by exploiting complementarities between trade promotion and private sector development. Technical assistance from MENA partners in the context of South-South exchanges should be explored in the agreements as a means to enhance trust.
- Clear rules and effective implementation. This would require reinforcing supranational institutional mechanisms to regulate, monitor, and implement trade integration provisions.