**Introduction:** Traditional discussions of export performance are typically cast in terms of countries and sectors—which has a comparative advantage, what should be protected, and so on. Yet, neither countries nor sectors trade; firms do. By exploiting a rich, firm-level data set on exporters in the Middle East and North Africa (MENA), the report with the same title that this Quick Note, sheds new evidence on a number of old questions—ranging from the effects of exchange rate policy to market structure to export promotion to industrial policy—where a firm-level perspective makes it possible to move beyond well-worn diagnoses and debates. While the findings in this report have implications beyond MENA, they have particular salience to the region where job creation and economic growth have never been more urgent.

1 The report builds on a series of background papers developed by an extended team of researchers under the “Exporters in MENA” project led by Mélise Jaud (task team leader - Economist, Office of the Chief Economist, Middle East and North Africa region, the World Bank), under the direction of Caroline Freund (senior fellow at the Peterson Institute for International Economics) and in collaboration with Ahmed Galal, Rana Hendy, and Chahir Zaki at the Economic Research Forum in Cairo. The authors express their thanks to the researchers for their contributions. They also thank Shantayanan Devarajan (Chief Economist of the World Bank MENA region) for his comments and guidance during the course of preparing this report. The authors thank Ana Fernandes and Denisse Pierola (Trade Research Group, the World Bank) for providing access to the Exporter Dynamics Database as well as firm level data for a number of non-MENA countries. They also thank the statistics and research institutions across the region that facilitated access to the firm-level data for MENA countries.

One Champion but No Team: The central finding of the report is that the size distribution of MENA’s exporting firms is suggestive of a critical weakness at the top. MENA has champions (the individual firms at the top of the distributions) of a size comparable to other regions, but it lacks teams of world-class exporters to surround and emulate the “number ones.” Its top 1 percent exporters are significantly smaller, on average, than in other regions. Thus, MENA countries have failed to nurture a group of export champions which critically contribute to export success in other regions.

Small size means that MENA’s champions do not punch as heavily as they should. This report uses a novel approach to the measurement of market power, relying on recent theoretical advances linking pricing-to-market behavior at the firm level to the extent of market power. Identifying pricing to market through the adjustment of producer prices to exchange-rate shocks, we show that MENA exporters lack market power on their destination markets compared to a control group of exporters from other developing or emerging regions. Being price takers is a consequence of being too small.

It may also be a consequence of insufficient innovation and drive. In other regions, the largest exporters lead the way in terms of specialization. That is, there is a close correlation between the prevalence of export superstars and the degree of sector-level comparative advantage. Not so in MENA, where the correlation is weaker, suggesting that large-firm strategies may reflect, at least partly, a legacy of distorted incentives.

These idiosyncratic features of MENA’s exporter population reflect a combination of structural and policy-induced factors. One is the well-known issue of an over-valued real exchange rate. The recent literature provides a wealth of evidence on the inhibiting effects of overvalued currencies on firm-level expansion of trade volumes and introduction of new products into new markets, with insights directly applicable to MENA. There is also the combination of tough, competitive European Union (EU) markets at the region’s doorstep, with poor, restrictive domestic environments, which makes for a formidable gap to jump over.

Severe Implications for Jobs: In view of the region’s acute job problem, the costs of MENA’s failure to develop effective export champions are potentially high. Thousands of new young people enter the labor force each year, and in the region’s volatile political environment, responding to their demands is crucial. Exporting firms, in particular in the manufacturing sector, hold the answer; they provide more and higher quality jobs, raising the return to education, and spreading the benefits of growth. Providing these firms with the right enabling environment is the region’s key policy challenge.

No Successful Exporting without Successful Importing: The report re-visits several traditional questions from the perspective of firms. First, it provides strong firm-level evidence that export performance correlates with the quality of imported intermediate inputs. While subcontractors in global value chains (GVC), being part of coordinated trans-frontier structures, incur no search costs, for independent mid-size companies, identifying reliable overseas suppliers can be a challenge. The region’s governments should break from their traditional logic of “export, do not import” and instead facilitate all firms’ access to imported inputs.

Regulatory Reforms Help Firm Competitiveness: The report also highlights the role that regulatory reform can play in enhancing firm competitiveness. Morocco’s regulatory harmonization with the EU while far from complete provides an interesting natural experiment to assess how tougher but modernized regulations affect firm performance. Contrary to widely-held views, tougher regulations, such as imposing hygienic practices during production or traceability requirements, do not necessarily hurt the competitiveness of domestic firms. They can have a “clean-up” effect on the
domestic market by keeping out lower-end suppliers, providing better incentives to upgrade quality. They can also help overcome managerial failures and encourage companies to innovate (Porter 1991; Porter and van der Linde 1995).

**Government Intervention, Beware of State Capture:** Sluggish export performance makes it tempting for governments in MENA to resort to industrial policy, in spite of the weak track record of State intervention in the region. Analysis of MENA’s prevalent cronyism and corruption under pre-Arab Spring regimes confirms that business-government ties led to distortionary allocation of favors and rent dissipation by beneficiary firms, with little evidence that those firms developed into national champions or helped lift the region’s export performance. This in itself should call for caution when advocating any form of government intervention.

**Some Export Promotion Programs Have Some Impact:** However, while the potential for capture and government failures is large, some forms of clinical intervention, like export promotion, seem to work. The problem, though, is that of size and scale. In Tunisia and elsewhere, such interventions tend to focus on small and medium enterprises (SMEs), often considered as prime job creators. As a matter of fact, firm-level evidence suggests that young age rather than small size is associated with job creation; out of many small firms, only a few young ones will grow and create jobs on a significant scale. Moreover, small firms only make up for a tiny share of aggregate exports. Thus, although export promotion programs may appear to work, they cannot be game-changers.

**Some Policy Options for Export Growth:** Taken together, the findings in the report suggest that the success of MENA countries to promote export growth and diversification as well as create jobs depends heavily on their ability to create an environment where large firms can invest and expand exports and new efficient firms can thrive to the top. A number of policy options are likely to help achieve this objective:

1. Governments in MENA should seek a competitive real exchange rate (RER) that will help firms grow and gain access to new markets. MENA exchange rate regimes are still predominantly pegged regimes. In a world where MENA exporters are faced with Chinese and other Asian price competitors, with currencies significantly undervalued against the dollar, the exchange rate cannot be ignored in a strategy to boost exporters’ competitiveness. How could MENA countries move to more flexible exchange rate regimes? Until now, any exchange-rate adjustment was difficult to manage fiscally because of the prevalence of energy subsidies. Eliminating subsidies especially now that energy prices are at an historical low is a first step in adjusting the exchange rate to more competitive levels.

2. Governments in MENA need to make significant strides in improving the business climate to facilitate the entry of young, efficient firms and attract productive foreign companies. For this, governments need to significantly reduce trade costs, by improving the quality of infrastructure, improving trade logistics, and streamlining export procedures. Eliminating restrictions on the internal movement of labor and goods will also help raise firms’ productivity and hence competitiveness. Governments also need to push trade reforms more energetically. Closing MENA markets to competition with high tariffs and restrictive non-tariff measures (NTMs) has not helped domestic exporters grow. The region’s governments need to facilitate efficient sourcing of inputs by eliminating high-tariffs on intermediate imports to help domestic firms’ participate in global value chains. Modernizing domestic NTMs will also help firms overcome managerial failures and encourage companies to innovate. Publicizing the domestic enforcement of high norms as a quality-signaling strategy may
also help expand the constituency in favor of more regulatory convergence.

3. Attracting foreign direct investment (FDI) has particular importance in the development of effective export champions. Superstars typically enter the export market when they are relatively large, often through foreign investment, and reach the top 1 percent within a few years of exporting. This highlights the role of multinationals in exports. Furthermore, the entry of new large exporters will expand competitive pressure on incumbents and boost overall performance. In MENA, the weaker performance and life-cycle dynamics of the top 1 percent could reflect lower levels of competition from foreign companies resulting from lower flows of FDI going to the region. Thus, policies to attract large, productive multinational firms are likely to be crucial for MENA countries’ exports and diversification. As foreign companies tend to pay higher wages, FDI would contribute to the job agenda too. Importantly, given the region’s track record, there is a very real concern that attempts to facilitate the emergence of export champions may be captured and tailored to a few, favored firms rather than enable the entry or growth of young productive ones.

4. Finally, if the goal is to increase export growth and diversification, MENA governments may need to rethink their approach to export promotion. The fact that very few large firms make up the bulk of exports implies that entry costs are relatively less important than variable trade costs for promoting aggregate exports. Policies that disproportionately allocate resources to help SMEs enter the export market, by lowering entry costs or offering subsidized resources, are unlikely, even if they work, to translate into economically meaningful aggregate effects—since these firms are too small to make a big difference. Only if SMEs in MENA are small because of distortions that prevent them from growing to be large firms, could policies that help eliminate such distortions have important aggregate effects. But their focus needs to be on removing distortions not promoting specific firms.

Many of these policy recommendations are the types of reforms that development institutions, such as the World Bank, have been advising countries in MENA to implement over the past decade. The difference this time is that the firm-level evidence in this report allows MENA governments to better quantify the costs, in terms of forgone trade and jobs, of not having moved ahead more rapidly on such reforms.

References:


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