Can Trade Be a Lever for Reforms in the Arab World?

Testimony by David L. Mack in Hearings of the Senate Finance Committee
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I am honored to appear before this committee to provide my personal perspective on the likely effects of Free Trade Agreements in the Middle East. My focus will be on the potential for FTAs and similar instruments to prod governments in the region into adopting economic reforms that will strengthen the private sector and lead to greater transparency and rule of the law. This will include regulations that do not stifle free market competition but do enforce measures against international crime and terrorist activities, including money laundering. My perspective is based on over 30 years as a US diplomat dealing with this region, three years as a private business consultant and the last six years as vice-president of a non-profit educational institution. With regard to the latter, I do not speak for the Middle East Institute, a broadly based member organization which does not take positions on policy issues, but in my personal capacity as an observer of trends in this region during the last four decades.

Israel, despite shortcomings in its economic system and the disincentives to private investment following decades of political turmoil and violence, is firmly embedded in the global economy and, since the 1960s, has multiplied its per capita income many times over. By contrast, most of the Arab countries and Iran are still textbook cases of stagnating or only slowly growing economies. My focus will be on the relationships between governments and their economies, a relationship which often serves to retard meaningful foreign trade, and the extent to which governments can do anything positive. There is often a nexus of relationships between government elites and a relatively few family commercial empires that dominate economic activity and hamper the emergence of competition, in both the domestic private sectors and from abroad. This reinforces a traditional mindset based on the notion that the economic pie is relatively finite based on wealth obtained from oil or other state controlled commodity exports and that competition is a zero sum game. Typically, this leads to high profit margins based on government contracts or government licenses, investment in non-productive enterprises such as real estate, outflows of surplus capital and limited possibilities for job creation by a broadly based commercial sector.

To start with, things really are better than they used to be. Whatever the statistics may show, Arab businessmen and their governments are increasingly conscious of the need to get beyond the constraints of doing business exclusively inside national economies. It has been a long time since I heard serious arguments for the need to insulate economies from foreign trade and investment beyond transitional periods. Mind you, foreign trade often gets lip service while little is done to break down the government and private barriers against it.

One positive development is that the official Arab Boycott of Israel exists increasingly only as a curious relic of the past. Not so long ago, it was effectively preventing major breakthroughs in foreign trade and investment, with perversely negative effects on the people of the boycotting states. In 1964, the Arab Boycott scored a decisive "victory" over Coca Cola when I was a Fulbright Scholar in Egypt. The stereotype of an Arab with a coke disappeared. In Egypt we had to make do with the sugary Masr Cola. The dead hand of Arab politics had triumphed. The loser was Coca Cola, the Arab consumer and Arab owned bottling and distribution agents. Later in my tenure in the UAE, I saw the Arab boycott of Coca Cola and many other US companies begin to melt away. In that country, as in some others in the region, chambers of commerce and other business minded organizations provide what is perhaps the most energetic lobby for economic rationality and change.

It is commonplace to describe Arab political economies as being subject to over regulation. Certainly this is one of the primary problems in a country like Egypt or Syria where the layers of regulations and bureaucracies seemed to extend back to Pharaonic times in Cairo and the Byzantine period in Damascus. But we also need to acknowledge the problem of under regulation in many of the newer states of the Gulf. As Ambassador to the United Arab Emirates, I saw at first hand the growing corruption and power in the private sector of the Pakistani-managed and Lichtenstein-headquartered Bank of Credit and Commerce International (BCCI), as well as numerous failing local banks being propped up by the various emirates. US and British bankers in the UAE told me that it was a country that badly needed to regulate its banks. A young, American trained UAE banking specialist named Sultan Al-Suwaidi drew my attention to the fact that the BCCI was able to offer a higher rate for deposits and a lower rate for loans than any other bank, suggesting that it was not the result of more efficient Pakistani management! Some years later, it cost the Emirate of Abu Dhabi an estimated 4 to 5 billion dollars to clean up the resulting scandals. Sultan Al-Suwaidi, incidentally, is now the Governor of the UAE Central Bank and is credited by US government officials with implementing model banking regulations, including strict prohibitions of money laundering.

In 1986, I found the UAE's small but lucrative markets filled to overflowing with fraudulent copies of brand name consumer goods, ranging from automobile parts to music cassettes. Each of the seven emirates of this confederation independently ran their commercial systems, a prerogative jealously guarded by the seven ruling families and the businessmen allied with them. As with the fledgling United States before adoption of the US Constitution, federal institutions in this area were weak to non-existent. The business establishments of the separate emirates were proud of a long tradition of unrestrained free enterprise. Rule of law, sanctity of contracts and transparency were at best unpredictable. Patents, trade marks, and copyrights enjoyed only the most spotty protection. In effect, the UAE risked becoming a pirate's cove with no meaningful intellectual property protections. Today, the UAE's record is much better in this area. Part of the reason for the improvement is over a decade of complaints from the US Government and other trading partners, as well as from the licensed local distribution agents for the manufacturers of imported consumer goods.

It helped that we periodically insisted upon negotiated agreements to avoid the equivalent of commercial war. This was met, initially, with cries of outrage from the UAE textile manufacturers who were expatriates, mostly from south Asian countries with over subscribed textile quotas. A combination of education and the pressure of deadlines achieved results. We arranged for senior officials from the federal ministries to have a thorough briefing in Washington on the harsh realities of the US political and economic environments which led to textile quotas. They returned and organized meetings of the government authorities and chambers of commerce of the various emirates where agreements were reached on negotiating strategies. In the end, the UAE emerged with a textile industry that had room for modest growth but was capped at a level that did not threaten the US industry.

Subsequently, we went through a similar exercise on issues of intellectual property. Once again, it was partly a matter of educating the emirate authorities. But it also involved the Embassy in local politics as we mobilized the often influential UAE businessmen who were the partners and agents for American companies. Deadlines were useful but had to be packaged in ways that encouraged the UAE to take pride in being respectable. Federal ministers admitted to me that they never could have wrested meaningful authority away from the individual emirates without the Damocles sword of potential US trade sanctions. So far, the newly empowered federal ministries are exercising their authority in a generally positive way and not evolving into obstructionist bureaucrats.

Beginning in May 1990, I became Deputy Assistant Secretary of State for Near East Affairs. Following the liberation of Kuwait, we agreed to begin in 1993 the first of what became annual economic dialogues with the six states of the Arab Gulf Cooperation Council – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. We had already developed close political and security relations with these governments. Economic relations, especially in the development and marketing of oil and gas, as well as the sale of US goods and services to rapidly developing petroleum-related industries was longstanding and formed the base for other relations. We were, however, beginning to lose ground to competitors from Europe and the Far East, especially in industries like aviation and consumer goods. Moreover, it was clear that the dominant oil and gas sectors of these economies were not creating jobs at anything close to the pace required to absorb the increasing numbers of young men graduating from high schools and universities, to say nothing of the women graduating in roughly equal numbers. Our intention was to inject new life into US relations with our Arab Gulf political and economic partners by encouraging economic and regulatory reforms.

Results of this first annual dialogue were disappointing. From my perspective, they were characterized by resounding affirmations of shared interests but a lack of serious self-examination. Many presentations by speakers from the region were long on assertions of opportunity for US firms but avoided commitments to the kind of reforms we suggested were necessary. In my luncheon address to the conferees, I reiterated the legal and administrative reforms by their governments that seemed necessary to us, but I made no commitments about what we might be prepared to do in response. My cautious call for gradual and orderly political reforms was met by a chilly silence, even though I knew that I was partly echoing the views of businessmen and intellectuals from the region.

In the years that have followed, I visited the region nearly each year and have noted that members of the Arab business communities are increasing vocal themselves in expressing the need for economic reforms. They understand that this is the price for entry into the global economy, either as members of the World Trade Organization or as partners with the United States in bilateral agreements. While they often complain about specific details of US negotiating positions, they understand that the discipline provided by this process may be a necessary catalyst for internal changes that have been stalled by inertia and tradition. Opposition to reforms is partly based on the narrow self interest of the few business families that enjoy the closest relations with government leaders, but there is also a broader fear that change will upset a familiar cultural order. Increasingly, however, there is a shared effort by reforming political leaders and the more dynamic members of the business community to assure greater transparency and rule of the law in commercial affairs. Partly because of US prodding but also on their own initiative, they are adopting new laws and improving the enforcement of measures against international crime and terrorist activities, including money laundering. They are trying to do this in a manner that does not stifle free market competition but is consistent with emerging global standards.

The example of the Free Trade Agreement with Jordan has had a strong, positive effect. It is not so much the great percentage increase in US-Jordanian trade since the FTA went into effect. It is understood that this resulted partly from a very low base and that the actual volume remains modest. Far more important are the non-quantifiable reforms that the Jordanian Government adopted to meet the preconditions for the agreement. In effect, Jordanian leaders took advantage of this instrument, using it as leverage to take internal measures that were long overdue. Eventual implementation of FTAs with Morocco and Bahrain will encourage the proponents of reform elsewhere in the region to take steps on their own to keep pace. From the US perspective, trade negotiations are a businesslike and non-sanctimonious way for us to promote reform in Arab countries.

There are no guarantees in this process, but there is now a keener understanding by governments and business establishments in the region of the connection between economic and social reform, especially educational reform, and their long term security. Moreover, there is an understanding that this has implications for the traditional political order, although commitment to change in that regard will be more cautious. It requires the vision to take risks and make uncomfortable adjustments. Resistance to high profile US pressure for political reforms is almost certain. Fortunately, some Arab leaders are initiating cautious measures in the directions of greater transparency in governance and wider participation in the political process. The success of such measures depends in part on their emergence as an authentic expression of local aspirations. In the meantime, Washington's renewed interest in bilateral economic cooperation will encourage the leaders from both the governments and the business communities that share these aspirations.

David L. Mack is Vice President of the Middle East Institute, a non-profit educational institution that does not take substantive policy positions. His remarks are his own, based on experiences which include service as the US Ambassador to the United Arab Emirates and as Deputy Assistant Secretary for Near East Affairs.