



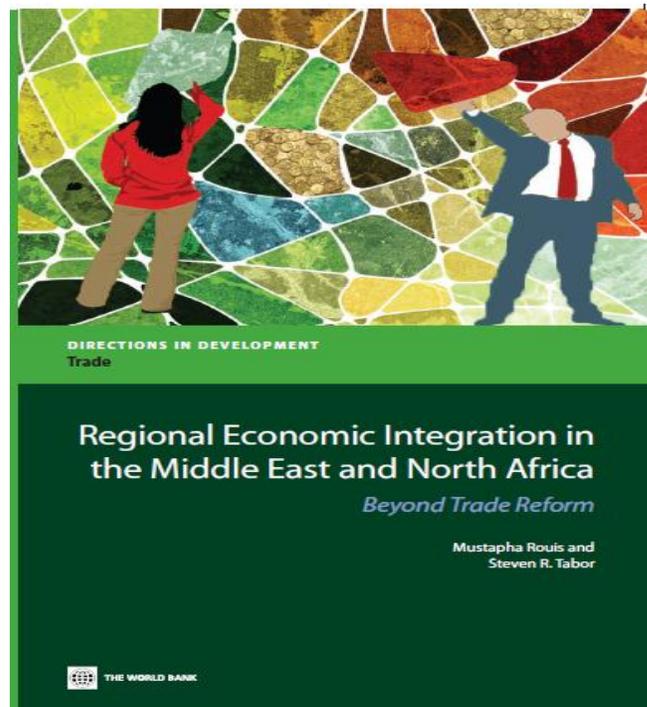
## Regional Economic Integration in the Middle East and North Africa

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**Introduction:** Limited integration has stifled the Middle East and North Africa (MENA) region's significant potential for economic growth and job creation. Home to 5.5 % of the world's population and 3.9 % of the world's gross domestic product (GDP), the region's share of nonoil world trade is only 1.8 %. By contrast, countries opting for a liberal trade and investment regime – most notably in East Asia – have seen significant increases in trade, employment, and per capita income. If petroleum and gas are included, MENA is far more integrated in the world economy, with exports accounting for 6.2% of global trade. Oil and gas exports are three-quarters of total MENA's exports.

MENA is characterized by exports of primary commodities, largely oil and gas (76% in 2008–10). Manufactured goods account for just over 11% with other sectors accounting for the remaining 13 %. MENA countries' exports are highly concentrated and less diversified overall in spite of recent efforts, with Egypt, Jordan, Lebanon, Morocco, and Tunisia faring better than the rest. Also, exports are unsophisticated, needing only low skill levels. Only 21 % of exports from the above five countries are medium or high-technology products compared to 37% in other middle-income economies. This combination of limited export diversification and low-technology industry hampers already low productivity growth.

MENA's service exports are currently dominated by low value-added tourism-related travel services. Travel and transport together made up 78% of total MENA service exports in 2008. In contrast, South Asia, led by India where information and communications technology and



finance are the leading export services and constitute 55% of service exports.

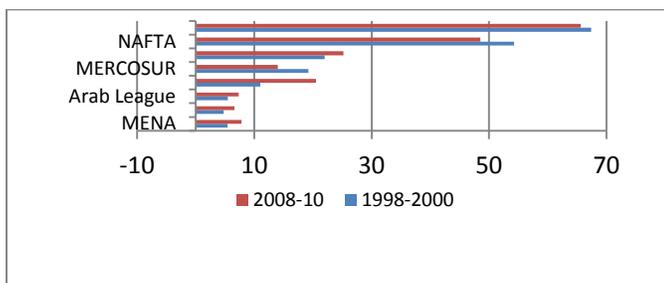
**MENA and Regional/Global Integration:** MENA is one of the least globally and regionally integrated regions. Its share in total world exports of nonoil goods remained below 1% for many years, gradually increasing in the past decade to reach 1.8% in 2008–10. Similarly, despite doubling services exports, MENA's share in total services trade has stayed at 2–3% in the past two decades. Last decade, however, most MENA countries began to open their economies. The United Arab Emirates (UAE), Qatar, Kuwait, Egypt, Jordan, Oman, and Iran have seen the fastest growth in exports in the region. Among oil importers, Egypt and Jordan have made significant progress in diversifying exports. Most Gulf Cooperation Council (GCC) exports also show

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reduced dependence on crude exports in favor of processed industries, including chemicals, fertilizers, and other petroleum-based products.

Integration within MENA is low compared to other middle and high-income regions. Intra-regional exports of goods averaged less than 8% of total exports in 2008–10, compared to 25% in the Association of Southeast Asian Nations (ASEAN) and 66% in the EU (figure 1). The countries that trade the most within MENA are oil importers, particularly Mashreq countries with strong links to the GCC (45% of their exports are within MENA) and Egypt (28%). Maghreb countries with close ties to the EU, export the least within the MENA region (less than 5 %) and among themselves.

**Figure 1: Share of Exports within Regions<sup>2</sup>**



**Tariffs and Non-Tariff Trade Barriers:** Over the last decade, preferential liberalization under the Pan Arab Free Trade Area (PAFTA) and other PTAs has been complemented by reductions in most favored nation (MFN) tariffs. The average uniform tariff equivalent of all tariffs (*ad valorem* and specific) for the region fell from nearly 15% in 2002 to 6% in 2009. In fact, MENA was the region where tariffs decreased the most during the global financial crisis, especially on manufactured goods. Yet, despite progress made in the last decade, tariff protection in MENA remains high by international standards. According to the Tariff-only Overall Trade Restrictiveness Index (OTRI\_T), only South Asia had higher levels of tariff restrictiveness. The MENA region compares unfavorably with competitors in Europe and Central Asia, Latin America and the Caribbean, and East Asia and the Pacific—the new dynamic poles of the world economy.

Wide variations in trade restrictions exist across MENA. The GCC has made tangible progress in improving

<sup>2</sup> World Integrated Trade Solutions (WITS), WTO International Statistics and World Development Indicators.

backbone infrastructure and reducing trade barriers. The GCC succeeded in bringing its common external tariff down to 5% on most imported merchandise and to zero on essential goods. North African countries continue to have prohibitive trade restrictions vis-à-vis the rest of the world. In Morocco the common weighted average import tariff in 2011 remained high at 17 %. 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 alone. Opening up the services trade would facilitate trade in parts and components and contribute to the emergence of regional production networks.

**Improving Infrastructure and Cross-Border Facilitation:**

Backbone services such as telecommunications, transport, and power are crucial to productivity and international competitiveness. Opening these sectors to competition and trade can help reduce production costs, increase FDI, promote knowledge spillovers, and expand markets, all of which enhance competitiveness. It is estimated that trade costs can constitute 20 to 40 % of the final delivered price of MENA’s nonoil exports. The cost of trade between neighbors is typically twice as high for MENA countries as in Western Europe. Maghreb countries face lower trade costs when trading with Europe than with each other. MENA’s trade costs are consistently higher for agricultural products, reflecting high transportation costs (per unit value), time sensitivity for perishable products, and the impact of border controls and nontariff measures. Although some MENA countries, like the UAE have excellent logistics facilities, most require substantial improvements in logistics and trade facilitation to decrease the cost of cross-border trading.

Efficient ports, maritime, and aviation services are crucial for the competitive export of goods. Most MENA countries have extensive road networks with high capacity in some areas, as well as important facilities for air and sea transport and, in several cases, a sizable rail network. Yet the quality of transport infrastructure is often deficient and unable to support modern economies. Implementation of the Mashreq Corridor Program to remove cross-border constraints is to increase trade by US\$ 15 billion per year by 2020 while generating some 250,000 permanent jobs. These jobs will mostly be in export-oriented light manufacturing that have a higher-than-average share of female jobs.

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

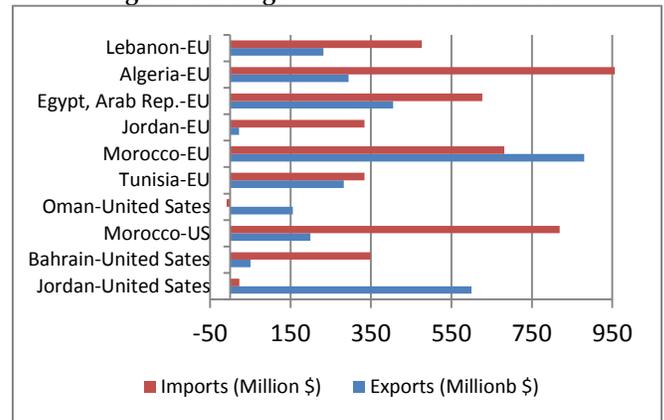
introduce competition in the power sector. Considerable progress has been made in regional integration of mobile telephony, but there are many important cross-border issues still to be tackled, particularly with regard to fixed and mobile broadband infrastructure.

**The Mixed Effects of Preferential Trade Agreements (PTAs):** Over the past 15 years, there has been an unprecedented worldwide increase in the number and scope of PTAs. The number of PTAs has doubled, reaching 278 at the end of 2010. PTAs have been employed in all regions with bilateral PTAs becoming the norm, often between countries in different regions. South-South PTAs represent about two-thirds of all PTAs and North-South PTAs about one-quarter. A large number PTAs have been adopted in MENA over the past decade and a half, both within the region and between countries of the region, the EU, Turkey, and the United States. This proliferation of PTAs, with their varying sector and product coverage, rules of origin, and implementation requirements, constitutes a formidable implementation challenge for capacity-constrained MENA institutions. This explains, in large part, why implementation of the PTAs has been a gradual process that is still evolving.

In MENA PTAs have contributed to a significant reduction in trade and investment barriers, provided an impetus for behind-the-border economic reforms, and helped spur rising trade. PTAs have also encouraged countries to improve their trade infrastructure, harmonize border policies and procedures, and improve supply chains and logistics facilities. There is little evidence regarding causality between PTAs and policy reforms, however, as countries such as Egypt, Jordan, Morocco, and Tunisia have embarked on major reforms on their own. There is also no evidence that PTAs have contributed to investment flows into the region. Total FDI has risen sharply in MENA over the past decade, but the bulk of it comes from within MENA, essentially from the GCC. EU and United States contributions have been relatively small.

The PTAs that MENA countries have signed with the EU and United States have led to a more rapid expansion in imports into the region than exports (figure 2). The findings from a gravity panel model prepared suggests that trade preferences granted to MENA countries by the United States, EU, and Turkey do not have an additional effect on exports compared to PTAs in general (which averages about 21 %). In fact, the

**Figure 2: Change in PTA Volume of Trade<sup>3</sup>**



additional effect is negative in the case of the EU-MENA PTA, not significant in the case of the Turkey-MENA PTA, and largely accounted for by Jordan's Qualifying Industrial Zone (QIZ) in the case of the US-MENA PTA. By contrast, PAFTA and the Agadir Agreement for the Establishment of a Free Trade Zone between Egypt, Jordan, Morocco, and Tunisia do have an additional effect in expanding the exports of their members. It should be highlighted, however, that this expansion is starting from a low intraregional trade base.

The ways in which rules of origin are calculated in different PTAs can inadvertently impede trade. Rules of origin exist in the different PTAs to preserve the value of preferences accorded to PTA members when they maintain different external tariffs. 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. The 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, rather than from the most competitive sources globally.

**Scope for 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 in global production chains.

<sup>3</sup> Figure 2 represents the change from 3-year average before entry into force to 3-year average after entry into force. See tables C27 and C28, pages 171 and 172 in the main report for sources.

While good progress has been made overall, with wide country variations, there remains substantial scope for further regional and global economic integration. To strengthen trade in goods, MENA countries could continue to unilaterally reduce their MFN tariffs, with an emphasis on reducing tariff peaks to the level of the most competitive regions of the world (for example, East Asia). Efforts could also be made to steadily roll back nontariff barriers to trade, which would involve reviewing existing nontariff measures, reducing their scope, and phasing out those that are not deemed essential for national security purposes.

Reforms to strengthen trade in services will be required and would include easing entry and licensing restrictions for domestic and foreign firms in services, promoting competition, harmonizing and strengthening regulatory practices, and lowering restrictions on the mobility of foreign workers in the region. Continued public ownership in services is a potential hurdle to increased regional cooperation, given the caution of the countries of the region on privatization. Addressing these issues would directly impact employment, the overriding challenge in MENA as services are labor-intensive and thus critical for more jobs.

Reducing the cost of trading across borders will mean increasing the efficiency of border-crossings, including the harmonization of custom procedures. Logistics systems need to be vastly improved by abolishing policies reserving logistics activities for specific categories of domestic firms. Transport networks will need strengthening to improve the efficiency of ports and make better use of regional railways. In the power sector, institutional prerequisites for cross-border power trade will have to be established along with strategic investments in regional distribution and transmission. Opening up backbone telecommunication infrastructure to competition and encouraging inward investment in broadband services will bring telecommunications costs down and make Internet services more readily available.

**Conclusion:** A development strategy based on regional and global economic integration has the potential to unlock MENA's untapped economic potentials. For this to happen, a broad reform agenda is needed which tailored to each country specific circumstances and stages of reform, is needed. The GCC countries have made substantial progress on reducing tariffs and nontariff measures and in improving trade logistics and infrastructure, but reforms are needed in the services area. In the Mashreq countries, which have strong links to the GCC, good infrastructure and cross-border trade facilitation should be prioritized. In the Maghreb, which has strong links to the EU, reducing tariffs and nontariff

measures and cross-border trade facilitation should be high on the reform agenda.

The political change sweeping through the Arab world provides an opportunity for the region to accelerate economic integration efforts. The Deauville initiative is timely in this regard. At its May 2011 meeting in Deauville, France, the G8 launched a strategic partnership with MENA countries undergoing political and economic change. This partnership calls on partner countries (Egypt, Jordan, Libya, Morocco, and Tunisia) to formulate homegrown economic and governance reform programs to enhance domestic competitiveness and promote trade and FDI. In return, the Deauville partners (which include, in addition to the G8, Kuwait, Qatar, Saudi Arabia, Turkey, the UAE, and nine international and regional financial institutions) committed to support the partner countries in achieving their goals of economic and political transformation through three strategic pillars: governance, finance, and trade and commerce.

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