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IS THERE POTENTIAL FOR ARAB REGIONAL INTEGRATION?

by

Mona Haddad

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Is There Potential For Arab Regional Integration?

By Mona Haddad

Paper prepared for the ESCWA conference on Review of Industrial Policies aimed at Increased Productivity and Competitiveness within Global Trends January 2001, Amman

The last decade saw an upswing in the pace of global economic integration: the ratio of world trade volumes to real GDP rose three times faster than in the previous decade; global foreign direct investment doubled as a share of world GDP to reach nearly US$200 billion in the 1990s; more and more services are transacted internationally. Globalization is altering the world economic landscape in fundamental ways. It is driven by a widespread push toward the liberalization of trade and capital markets, increasing internationalization of corporate production and distribution strategies, and technological change that is rapidly dismantling barriers to international trade and mobility of capital.

Globalization has profound implications for developing countries. It creates important new opportunities—wider markets for trade, larger private capital inflows, improved access to technology. The new opportunities are accompanied by tough new challenges of economic management. Global integration requires adopting and maintaining a liberal trade and investment regime. In trade, competition is increasingly stiff. In finance, international capital market integration and the potential volatility that comes with it are making macroeconomic management in developing countries more complex. With financial markets so highly integrated, problems are transmitted rapidly from one country to another, with detrimental effects on exchange rates, output, and employment.

As a result of recent financial crises such as in East Asia, Mexico, or Russia—which are often referred to as crises of globalization—many developing countries are contemplating strengthening regional integration as they move towards globalization. Regionalism can provide a means for developing countries to foster their development process and address the challenges of globalization. Although generally regional integration arrangements among developing countries have not worked well in terms of trade creation, the indirect effect of regionalism on changing the ways in which countries interact and respond to shocks in the world economy is important. Regionalism may also provide countries with a market where they can compete more effectively and hence be better prepared to face increasing competition in the world market as they globalize.

This paper is divided into two parts. The first part assesses the potential for a successful regional integration among Arab countries. First, it analyzes the extent and profile of regional integration. Second, it evaluates prospects for regional integration among Arab countries. Finally, it provides recommendations for achieving a stronger and lasting regional integration. The second part discusses the recent Great Arab Free Trade Area agreement. It describes the main elements of the agreement and its achievements so far, and it assesses its strengths and weaknesses.

I. ARAB REGIONAL INTEGRATION: STATUS AND PROSPECTS

a. How integrated are Arab countries as a region?

The Arab region is important to the world economy; it boasts a rich endowment of natural resources—including about two-thirds of the world's known oil reserves—a large labor force, and a well-established tradition of trade. Despite favorable geographical and cultural elements, the Arab region remains remarkably unintegrated economically—intra-regional trade is small, labor flows are large but skewed, and private capital transactions remain limited.

Many characteristics of the Arab region favor regional integration. Arab countries are often complementary in their human and natural endowment. Some are characterized by harsh climates and limited groundwater and rainfall, others have very productive agricultural pockets. The region is rich and diverse in its natural resources, including crude oil, numerous non-fuel minerals, and non-mineral resources. Some Arab countries have an abundance of labor while other have a shortage. Populations range from over 60 million in Egypt to around 0.5 million in the smaller Gulf countries. Moreover, the Arab region is highly homogenous culturally but diverse politically. Countries share a common language, a predominantly common religion, and a rich historic heritage—much more than APEC countries and similar to Latin America. The region, however, remains diverse in terms of political systems and governance.

However, the Arab region is particularly unintegrated on the economic front. There has been very little effective regional economic policy coordination. Trade integration specifically has not been successful, mainly because of substantial economic heterogeneity among countries. Economic integration among Arab countries started with the Agreement on Mutual Defense and Economic Cooperation between Arab League States in 1950. Ambitious plans for trade integration contained in the design of the Arab Common Market established in the 1960s have remained largely unimplemented. Several regional integration arrangements followed but had little impact.

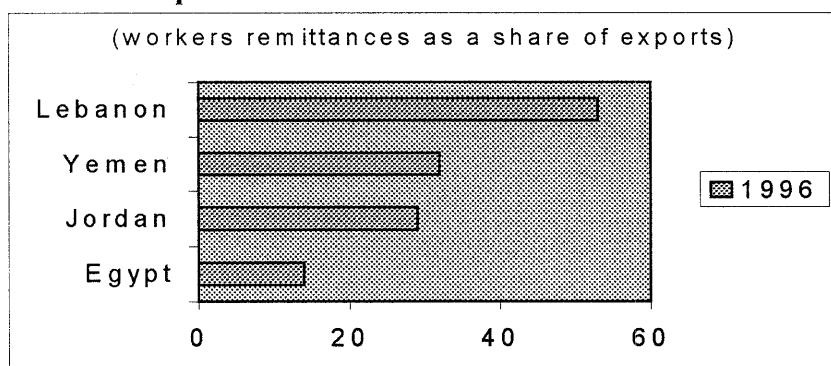
The search for alternative strategies of economic integration resulted in the establishment of many bilateral or subregional agreements. Cooperation efforts have achieved considerable success in the case of the Gulf Cooperation Council (GCC) in terms of economic coordination and harmonization of policies, but the creation of a customs union is still facing constraints. A renewed effort for regional trade integration started in 1998 with the decision to create a Great Arab Free Trade Area (GAFTA) over a ten-year period. GAFTA is designed to include all Arab countries as members, to respond to the circumstances and needs of its various members, and to observe consistency with the rules of the World Trade Organization (WTO).

Labor markets in the Arab region are highly integrated relative to other regions of the world. Large intra-regional labor movements have been the main vehicle of the region's economic integration, triggering substantial flows in the form of workers' remittances and transmitting economic impulses across countries. To a large extent, labor movement has been from non-oil to oil countries within the Arab region. In the early 1990s, the stock of foreign labor into the Gulf countries reached 5 million and accounted for about two thirds of the total labor force of the GCC countries; of these, 55 percent came from Arab countries. This share has decreased since the mid-1990s as the share of

Asian labor has increased. The Arab labor force in the Gulf is expected to decline further as policies of substituting national for foreign manpower are carried out by Gulf states.

The inflow of Arab manpower into the Gulf has been beneficial for both the exporting and importing countries. For oil economies it provides needed skilled and unskilled manpower in various fields. For exporting countries, it is a source of employment for often excess labor. Moreover, labor remittances have a direct balance of payments impact and account for much of private investment in certain countries in the region (such as Jordan and Lebanon). Remittances have recently amounted to about one quarter of exports of goods and services of non-oil exporters in the region and have exceeded 30 percent in Lebanon, Yemen, and Jordan (Figure 1.1). Workers' remittances were equivalent to about 20 percent of GDP for Jordan and 11 percent of GDP for Egypt in 1993.

Figure 1.1: The importance of workers remittances in some Arab countries



Source: ESCWA, *The ESCWA Region: Twenty Five Years,* 1999.

Intra-regional capital flows are primarily in the form of foreign assistance—mainly from the oil exporters like Kuwait, Qatar, Saudi Arabia, and the UAE to poorer countries—which is highly correlated with the donor's economic circumstances and thus with fluctuations in world-market prices of oil. During 1993-95, Arab aid averaged between 3 and 6 percent of the individual GDP on non-Gulf Arab countries. Private capital flows within the region have been relatively limited. While cross-border transactions between the financial markets of the GCC countries increased significantly in recent years, from about 5 percent of their total transactions with the world in 1992 to 20 percent in 1996, they remained negligible with the other Arab countries, at 0.5 percent of total transactions. Intra-regional investments have been mainly in those member countries which implemented policies conducive to strengthening the operational framework for the domestic financial market, such as Egypt.

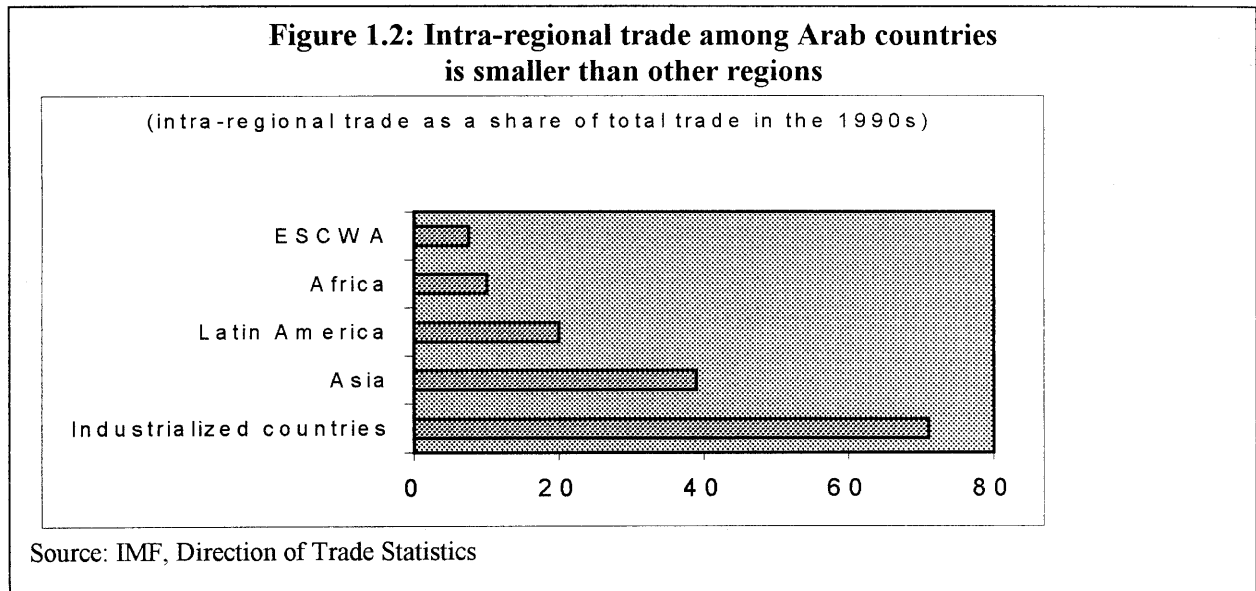
Intra-Arab trade: a profile

Until recently, Arab countries were not open to one another in terms of trade, and more generally to the outside world, with the prominent exception of the GCC countries. The fragmentation and highly protected markets tended to inhibit the expansion of intra-Arab trade. It also led to lack of

inducement for the industrial production to incorporate up to date technologies and management techniques and follow lines of specialization that a larger, freer market would have induced.

Over the past two decades, the share of intra-Arab trade in the total trade of the Arab region remained below 10 percent. By comparison, the share of intra-Asian trade was about 40 percent and of intra-Latin American trade was about 20 percent in the 1990s (Figure 1.2); moreover, the share of intra-NAFTA trade was 40 percent of its total trade and of intra-EU almost 60 percent in 1997. Moreover, the speed of regional trade integration diminished—the annual average rate of growth of intra-regional imports dropped from 14 percent during 1986-89 to 7 percent during 1990-96.

Figure 1.2: Intra-regional trade among Arab countries is smaller than other regions



Source: IMF, Direction of Trade Statistics

The low intra-regional trade at the aggregate level hides a more complex and skewed structure of trade. A more disaggregated analysis reveals greater intra-regional trade in non-oil commodities, intense bilateral trade relations among certain countries, differences in the importance of intra-regional trade for different groups of countries, and a high reliance of the region on the rich oil-exporting countries as trade partners.

First, the limited share of intra-Arab trade is partly due to the dominance of oil export, which is primarily destined to the industrial countries. If oil is excluded, the share of intra-Arab exports would rise to an average of 30 percent in recent years (1992-94) compared with 7 percent with oil.

Second, although on an aggregate basis regional trade is limited and most trade is conducted with the European Union, there are relatively intense trade relations within sub-groupings, especially neighboring countries, much higher than in other trading blocks between developing countries. For example, trade intensity indicators[1] are high for bilateral trade between Lebanon, Jordan, and Syria

[1] Trade intensity indicators measure the ratio of the share of a given country's exports in total imports of a member country to the percentage this country has in total exports in world trade. If the former share is larger than the latter (the indicator is greater than 1), this indicates that the country trades with its partner on a scale which is larger than warranted on the basis of equal distribution of trade among countries.

(Table 1.1), suggesting that the actual trade flows among them is more intense than what is considered "normal". Moreover, over 70 percent of GCC's intra-regional exports are among each other (Table 1.2).

Table 1.1: High trade intensity among some Arab countries
(trade intensity indices, 1996)

	Egypt	Jordan	Lebanon	Syria
Egypt	--	4.0	6.5	0.9
Jordan	20.8	--	55.3	43.5
Lebanon	7.0	16.9	--	54.2
Syria	12.2	35.9	56.5	--

Source: H. Ebbers, 1998, *Economic Integration in the Middle East and North Africa: Factors Explaining Readiness for and Failure of Regional Integration,* Paper presented at the Arab Planning Institute, 1998.

Third, the importance of intra-regional trade varies across countries. For oil-exporting countries, intra-regional trade as a share of their total trade is small—for Saudi Arabia, for example, exports to the region represented only 8 percent of its total exports in 1997 and imports from the region only 6 percent of its imports (Table 1.3). For non-oil producing Arab countries, the Arab region constitutes an important export market—in 1997, the share of exports to the region in total exports was 47 percent for Jordan, 45 percent for Lebanon, and 20 percent for Syria.

Table 1.2: Indicators of intra-Arab trade, 1998

	Exports by:		
	Arab countries	GCC countries	More diversified economies
	(intra-regional exports, as a percent of exports to Arab countries)		
Exports to:			
Arab countries	100.0	100.0	100.0
of which:			
Maghreb	16.7	7.7	14.7
GCC countries	56.6	71.4	44.9
More diversified economies	21.8	15.6	37.7
Other	4.9	5.2	2.7

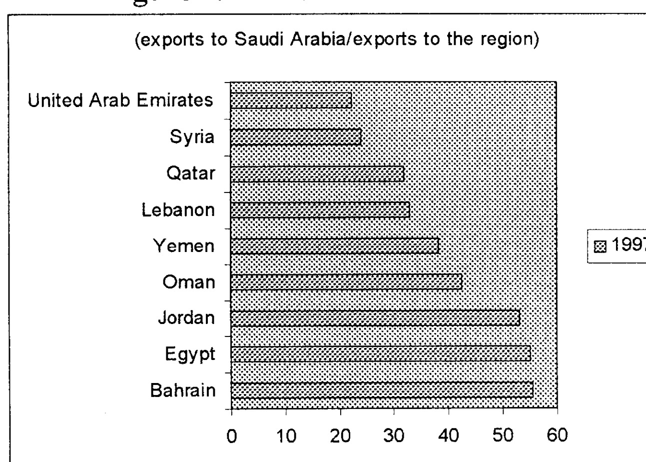
Source: Al-Atrash, H. and T. Youssef, *Intra-Arab Trade, Is it too Little?* IMF, 2000.
Note: Maghreb includes Algeria, Libya, Mauritania, Morocco, Tunisia; GCC includes Bahrain, Oman, Qatar, Saudi Arabia, United Arab Emirates; More diversified economies include Egypt, Jordan, Lebanon, Syria, Sudan; Other countries include Djibouti, Somalia, Yemen.

Table 1.3: Intra-regional trade among Arab countr ies, 1997

	Intra-regional exports			Intra-regional imports		
	Value (US$ million)	Share in region (%)	Share in own total exports (%)	Value (US$ million)	Share in region (%)	Share in own total imports (%)
Arab region	10,465	100.0	8.6	11,122	100.0	10.8
GCC countries	8,291	79.1	7.6	8,251	69.2	8.5
Bahrain	516	4.2	10.2	2,147	3.8	8.9
Kuwait	391	3.8	2.7	1,067	11.4	12.9
Oman	762	7.3	10.2	1,473	15.8	29.3
Qatar	354	3.4	8.6	523	5.6	14.5
Saudi Arabia	4,381	42.2	8.3	1,638	17.5	6.0
United Arab Emirates	1,887	18.2	7.5	1,403	15.0	5.0
More diversified economies	2,174	20.9	17.7	2,871	30.8	9.3
Egypt	374	3.6	9.6	564	6.0	4.3
Jordan	714	6.9	47.5	918	9.8	22.4
Lebanon	289	2.8	45.0	619	6.6	8.3
Syrian Arab Republic	785	7.5	20.0	269	2.9	6.7
Yemen	39	0.4	1.7	501	5.4	24.6

Source: ESCWA, Survey of Economic and Social Developments in the ESCWA Region, 1999.

Figure 1.3: The role of Saudi Arabia



Source: IMF, Direction of Trade Statistics

Fourth, intra-regional exports and imports for each country is heavily concentrated in two or three partners, with Saudi Arabia being the first or second major trade partner for all countries of the region, except Kuwait (Figure 1.3). With a per capita income over US$6000 and an open trade regime, Saudi Arabia is the largest import market in the Arab region (and one of the top fifteen importers in the world). While Saudi Arabia absorbs over 40 percent of Arab countries' exports to the region, this represents a very small part in total Saudi imports (6 percent). The small industrial base in the Arab countries and the types of commodities that Saudi Arabia needs for its development (machinery, high-end products) are the main factors responsible for the low share of Arab exports to the Saudi market. But as these countries develop, there is a large potential for further regional trade with Saudi Arabia.

Composition of intra-regional trade: beyond the oil factor

Because exports in the Arab region are dominated by oil and oil products, aggregate trends in intra-regional trade are biased by developments relating to these products and would not accurately reflect the evolution of intra-regional trade in other sectors. Many products are gaining importance in intra-regional trade beyond petroleum. Among the thirty largest three-digit SITC products in intra-regional trade (Table 1.4), crude petroleum accounted for 12 percent of major exports in the mid-1990s, followed by iron and steel (6 percent), plastic material (4.5 percent), motor vehicles (4.5 percent), petroleum products (3.8 percent), and fresh vegetables (3.7 percent). This variety of products reflects the different factor endowments of countries in the region and their comparative advantage—some are rich in oil, some are agriculture-based, some rely on low-skilled labor, and some have engaged in re-exports (e.g., motor vehicles in Oman and Bahrain).

While intra-regional exports stagnated between the mid-1980s and the mid-1990s, this result is biased by petroleum whose price dropped by about 60 percent over this period. If petroleum is excluded, trends in intra-regional exports are positive. Exports of major products other than petroleum approximately doubled over the decade to about $7 billion. Moreover, while the overall growth rate of intra-regional exports was close to zero between the 1980s and the 1990s, intra-regional exports excluding oil were growing at an annual rate of about 7 percent. Of these major intra-regional exports, several skill-intensive products—such as organic chemicals, plastic materials, and electrical distribution machinery—grew at above 10 percent between the 1980s and the 1990s. Furthermore, manufacturing exports have aquired a growing importance, accounting for almost three-quarters of the major products.

Exports of some new products within the region are also growing fast, although they still do not account for a major share of intra-regional exports. The fastest growing intra-regional exports vary in skill and factor intensity (Table 1.5)—from pig iron and synthetic dyes (capital intensive), to vegetable oils, leather, and cotton (labor intensive). These fast growing exports accounted for about 18 percent of intra-regional exports in the mid-1990s. Furthermore, there is a high concentration in the countries accounting for these fast growing exports—Saudi Arabia and Turkey are the main suppliers of these dynamic exports within the Middle East region. To a large extent, these dynamic exports reflect a better utilization of factor endowment—GCC countries are rich in capital and poor in labor while Syria and Egypt are rich in cheap, unskilled labor—as well as the effort of some countries, especially GCC, at diversifying their economies.

Table 1.4: Thirty largest products in Middle Eastern countries' regional exports

	Value of Exports ($ million)		Percent of All Exports (%)		Growth Rate
Commodity (SITC)	Mid-1980s	Mid-1990s	Mid-1980s	Mid-1990s	1980s-90s
Crude Petroleum (331)	5,648.9	1,581.4	46.5	12.5	-9.8
Iron and Steel Shapes (673)	337.9	761.7	2.8	6.0	6.3
Plastic Materials (581)	108.9	570.7	0.9	4.5	12.7
Road Motor Vehicles (732)	566.3	567.9	4.7	4.5	0.0
Petroleum Products (332)	473.1	478.4	3.9	3.8	0.1
Fresh Vegetables (054)	242.4	463.0	2.0	3.7	5.0
Clothing Not of Fur (841)	172.2	384.5	1.4	3.0	6.2
Fresh Fruit and Nuts (051)	247.3	341.7	2.0	2.7	2.5
Aluminum (684)	102.5	318.9	0.8	2.5	8.7
Cement and Building Products (661)	124.5	295.4	1.0	2.3	6.6
Non-electric Machinery, nes (719)	81.9	234.8	0.7	1.9	8.1
Live Animals (991)	355.8	223.9	2.9	1.8	-3.6
Tobacco Manufactures (122)	30.5	193.6	0.3	1.5	14.2
Electric Distribution Machinery (723)	37.5	190.0	0.3	1.5	12.5
Articles of Paper (642)	39.8	182.3	0.3	1.4	11.7
Textile Yarn and Thread (651)	163.7	181.6	1.3	1.4	0.8
Chemicals, nes (599)	29.7	170.3	0.2	1.3	13.4
Cleaning Preparations (554)	41.3	145.8	0.3	1.2	9.7
Floor Coverings (657)	68.7	133.2	0.6	1.1	5.1
Organic Chemicals (512)	29.9	131.2	0.2	1.0	11.4
Woven Non-cotton Textiles (653)	119.8	124.7	1.0	1.0	0.3
Iron and Steel Tubes (678)	69.7	121.0	0.6	1.0	4.2
Machines for Special Industries (718)	68.3	115.6	0.6	0.9	4.0
Iron and Steel Primary Forms (672)	26.4	114.9	0.2	0.9	11.3
Copper (682)	20.9	114.3	0.2	0.9	13.1
Articles of Plastic, nes (893)	38.5	113.6	0.3	0.9	8.3
Medicinal Products (541)	35.8	110.9	0.3	0.9	8.7
Inorganic Elements and Oxides (513)	38.1	109.2	0.3	0.9	8.1
Structures and Parts (691)	83.0	104.9	0.7	0.8	1.8
Cotton (263)	8.4	103.8	0.1	0.8	19.3
ALL ABOVE PRODUCTS	9,411.5	8,683.3	77.5	68.5	-0.6
Excluding Petroleum	3,762.6	7,101.9	31.0	56.1	6.6
ALL EXPORTS	12,143.9	12,671.8	100.0	100.0	0.3

Note: Middle East includes non-Arab countries such as Iran and Turkey.
Source: Yeats and Ng, World Bank, mimeo

Table 1.5: Dynamic products in Middle Eastern countries' regional exports

Product (SITC) and Factor Intensity	Major 1990s Supplier (share)	Exports to the Region ($ million) Mid-1980s	Mid-1990s	Growth Rate 1980s-90s
Pig Iron (671)***	Bahrain (93)	0.7	99.3	38.6
Iron Wire (677)**	Libya (48)	0.5	27.1	30.3
Aircraft (734)***	Turkey (87)	1.1	53.4	29.7
Fixed Vegetable Oils (422) *	Bahrain (39)	2.0	89.2	29.1
Leather (611)*	Egypt (31)	0.7	27.6	28.8
Zoo Animals (941)****	Oman (78)	1.1	25.7	24.0
Milk and Cream (022)**	Saudi Arabia (79)	5.3	96.2	22.3
Lead (685)***	Saudi Arabia (77)	0.6	9.3	21.0
Cotton (263)*	Syria (46)	8.4	103.8	19.3
Crude Animal Materials (291)*	Yemen (21)	0.8	7.4	19.1
Preserved Meat (013)**	UAE (51)	2.1	23.7	18.5
Synthetic Dyes (531)***	Turkey (40)	0.5	5.4	18.3
Sulphur (274)***	Iran (69)	0.7	6.8	17.5
Iron and Steel Strip (675)**	Libya (100)	1.0	9.0	17.2
Undressed Hides (211)*	Iran (46)	5.9	52.1	16.6
Chocolate and Products (073)**	Turkey (65)	4.1	33.6	16.1
Margarine & Shortening (091)**	Turkey (86)	7.7	61.1	16.0
Photographic Supplies (862)***	Oman (70)	1.3	8.6	14.3
Tobacco Products (122)***	Oman (56)	30.5	193.6	14.2
Essential Oils (551)**	Saudi Arabia (50)	0.9	5.8	14.0
Animal & Vegetable Oils (431)*	Turkey (82)	9.7	59.7	14.0
Special Textile Products (655)*	Turkey (86)	12.7	70.5	13.2
Copper (682)***	Turkey (48)	20.9	114.3	13.1
Wheat Meal or Flour (046)**	Oman (44)	9.4	51.1	13.0
Plastic Materials (581)***	Saudi Arabia (67)	108.9	570.7	12.7
Wire Products (693)**	Saudi Arabia (79)	16.3	83.3	12.6
Electrical Distributing Machines (723)***	Saudi Arabia (55)	37.5	190.0	12.5
Paper Pulp & Waste (251)***	Saudi Arabia (51)	0.5	2.5	12.2
ALL ABOVE PRODUCTS	Turkey (23)	322.3	2,260.5	15.0
As a Percent of All Regional Exports		2.7	17.8	
ALL REGIONAL EXPORTS		12,143.9	12,671.8	0.3

* Generally manufactured by relatively labor intensive techniques.
** Generally manufactured by techniques of average labor intensity.
*** Generally manufactured by relatively capital intensive techniques.
**** Factor intensity information not available.

Source: Yeats and Ng, World Bank, mimeo.

b. Prospects for regional integration in a globalization era

Within the global integration framework, the WTO rules allow regional trading arrangements among countries, provided certain criteria are met (Article 24 of GATT). In particular, the arrangements should help trade flow more freely among the countries in the group without barriers being raised on trade with the outside world. In other words, regional integration should complement the multilateral trading system, not threaten it. "...To a much greater extent than is often acknowledged, regional and multilateral integration initiatives are complements rather than alternatives in the pursuit of more open trade" (WTO, 1995).

There is increasing attention devoted to the prospects and implications of regional integration in developing countries as a means to provide a temporary shield against the risks of globalization and improve their potential to benefit from the opportunities of globalization. Regionalism among developing countries may allow them to increase their trade competitiveness and strengthen their financial markets in a less risky environment, thus increasing their preparedness in facing the global competition in trade and the volatility in capital markets.

In the Arab countries, there is scope for greater regional integration. Although most countries in the region will continue to trade mostly outside the region—primarily with Europe, the United States, and Asia—the volume and the share of regional trade can rise significantly as a result of greater regional integration, leading to substantial economic gains. Increased regional interaction among Arab countries could also stimulate growth and employment, which are a major challenge facing the region. In a world market characterized by increasingly stiff competition from regions like Eastern Europe and Asia, further regional integration could allow many Arab countries to compete more efficiently, thus acting as a building block towards globalization of the region.

Scope for greater regional integration: traditional arguments

Arab countries have the right ingredients to gain from further regional integration. With the low level of economic interaction within the Arab region, there is potential for far greater integration, especially in trade and investment flows. Closer integration is unlikely to lead to much trade diversion in commodities already traded in the region, but should promote greater merchandise trade in other commodities.

First, many aspects of the region favor trade creation. The region has a diverse natural, human, and financial endowment base that is spread among countries in the region. Its relatively high initial trade barriers suggest a scope for trade-creating gains from regional integration. Also, with an average per capita income well above that of developing countries as a whole, and with about 3 percent of the world's population, the region offers a large market with considerable purchasing power. Countries within the Arab region have well-established trade links and relatively accessible intra-regional trading routes.

Second, trade diversion is unlikely in commodities already traded in the region. In some Arab countries, a single sector accounts for over half of GDP (e.g., oil in the GCC countries). Others, such as Egypt, Lebanon, Jordan, are more diversified with an important manufacturing component, although varying in terms of technology level. Much of the trade within the region is based on this

diversity, with oil the main traded commodity and labor the main traded factor. This trade is unlikely to be altered.

Third, beyond its effects on merchandise trade, regional integration would boost service flows and intra-regional investments. Arab residents hold a very large share of their portfolios outside the region, with estimates ranging from US$350 billion to US$600 billion. Given the right economic policies in recipient countries—such as an investment code that conforms to the highest international standards, institutional strengthening, and improved governance—even a small reallocation of portfolios in favor of the regional activities would make a large difference in the region's investible resource base. Commonality of language and cultural affinity should facilitate labor and tourist flows within the region and promote regionalism.

Regional integration as a building block to globalization: new arguments

The recent discussions of globalization raise the question of how Arab countries will fare in a more competitive environment. Most Arab countries have traditionally been dependent on their natural resources and, as a consequence, they have had fewer pressures to diversify and specialize their industrial base. Intra-industry trade (IIT)[2] is indicative of the level of industrial advancement and of the implied potential to compete with industrialized economies in a more open trade setting. This indicator is used in this section to determine the level of industrial progress in Arab countries and the potential for success in regional trade.

In the trade literature, the amount of intra-industry trade, or trade in similar goods which a country undertakes, is often taken as a measure of the diversity, degree of specialization, and degree of technical sophistication of its industrial sector. Traditional trade theory suggests that the potential payoffs from the opening of trade among countries that formerly did not trade much with each other increase when the more complementary the structure of their economies are. However, the creation of a customs union among countries that could trade before is more likely to be welfare-enhancing for its members the more similar the range of goods they produce—and thus the greater intra-industry trade—because trade creation is more likely to dominate trade diversion under those circumstances. This new theory certainly applied in the case of the European Union.

Overall, the Arab region does not have a highly advanced industrial base, with an average IIT index of 16 percent for the period 1992-94 (Table 1.6). This IIT level falls well below those recorded in industrial countries, in particular the EU, which have an average IIT index of 88 percent. IIT levels for Arab countries are also lower when compared to other regions that have already implemented trade arrangements, such as NAFTA and APEC, or even in relation to Mercosur, which has comparable per capita income levels. However, the Arab region does show positive signs of rapidly increasing IIT levels over the past decade.

In addition to having significantly lower IIT levels in global trade than other countries, Arab countries also have lower IIT levels in trade with the EU or the world as opposed to intra-regional trade or trade with other developing countries. This means that Arab countries trade more with each other in similar goods than they do with the EU or the world as a whole. No single Arab country has

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[2] Following Grubel and Lloyd (1975), the measure for intra-industry trade in product i at the three-digit SITC level is: $IIT_i=[(X_i+M_i)-| X_i+M_i|]/(X_i+M_i)$. The index will be zero if there is no intra-industry trade and one if all trade is intra-industry.

higher IIT levels in trade with the EU than with other Arab countries or other developing countries. This suggests that Arab countries have more similar levels of industry specialization, and that they compete more effectively in the intra-regional setting than in the global setting. Thus intra-regional trade (and trade with developing countries) provides an opportunity for Arab countries to compete more effectively in intra-industry trade, and could be viewed as reinforcing the position that globalization and bilateral trade agreements between the Arab countries and the EU could be accompanied by regional liberalization.

Table 1.6: Intra-industry trade indices in manufactures, 1992-94

	Trade with:			
	World	Developing countries	European Union	Arab countries
Arab countries	16.1	20.5	12.8	21.1
Oil exporting	14.2	17.2	13.6	18.9
Non-oil exporting	17.9	23.8	11.9	23.7
Kuwait	13.1	25.6	8.1	19.1
Oman	41.4	36.5	20.4	6.3
Qatar	7.6	7.1	8.0	11.1
Saudi Arabia	12.5	21.2	5.6	20.3
United Arab Emirates	8.1	9.3	19.9	24.8
Syria	12.5	21.2	5.6	20.3
Jordan	24.8	25.4	10.0	22.0
Egypt	17.2	25.0	11.3	27.8
Comparator countries				
Algeria	5.2	10.7	4.7	9.7
Morocco	20.4	28.1	15.8	21.6
Tunisia	30.1	38.0	24.3	26.8
Israel	58.4	32.2	42.5	19.0
Turkey	28.4	45.5	23.2	11.9
Industrial countries	87.8	--	--	--
APEC	90.3	--	--	--
Mercosur	51.9	--	--	--
NAFTA	77.3	--	--	--

Source: Havrylyshyn and Kunzel, *Intra-Industry Trade of Arab Countries: An Indicator of Potential Competitiveness*, IMF, 1997.

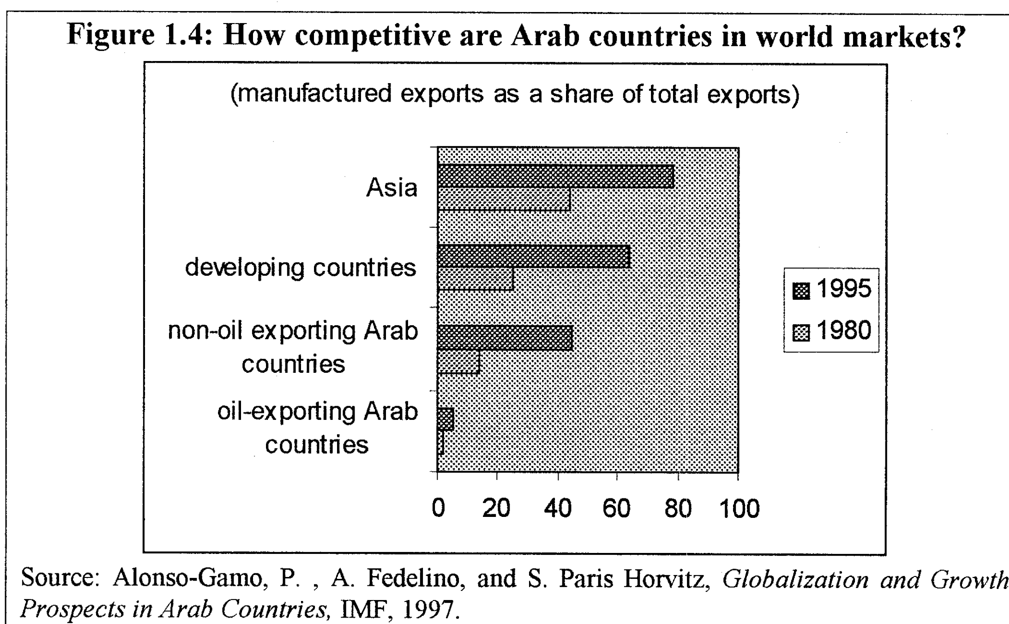
c. Towards a successful regional integration

The scope for increased regional integration exists. However, in order to implement a successful integration and benefit from the potential benefits, Arab countries need to implement the appropriate policies for increased integration within the region and with world markets while minimizing the risks of adjustment. Managing increased trade integration for the region would require macroeconomic stability across countries, continued trade liberalization, continued improvements in physical and institutional infrastructure, a safety net to cushion the adjustment

costs during the transition period, and an enhanced education system to increase labor market responsiveness to new opportunities.

Increasing export competitiveness and widening the industrial base of Arab countries will be crucial to better match export potential with import needs within the region. The ratio of manufactured exports to total exports—a good indicator of a country's competitiveness in foreign markets, technological progress, and production diversification—is below the average for developing countries (Figure 1.4). This ratio is on the rise for non-oil Arab countries but not for major oil-exporting countries. For the GCC countries and Syria, the bulk of foreign export earnings is still comprised of fuel exports. Only a limited number of countries—Egypt, Jordan, Bahrain, and more recently Oman—have a significant ratio of non-fuel exports to total exports.

Figure 1.4: How competitive are Arab countries in world markets?



Source: Alonso-Gamo, P. , A. Fedelino, and S. Paris Horvitz, *Globalization and Growth Prospects in Arab Countries,* IMF, 1997.

Moreover, there is a need to liberalize trade further. Trade restrictions in the region have been reduced in recent years, but they remain relatively high for many non-GCC countries. While most GCC countries—such as Bahrain, Oman, and Saudi Arabia—have open trade regimes with average tariff levels below 15 percent, the latter are close to or above 30 percent for most non-GCC countries (compared with 14 percent in Latin America and 9 percent in Central Europe in 1996). In most recent years, a number of Arab countries, like Jordan and Egypt, have pursued greater trade liberalization by dismantling the systems of quantitative controls, cutting tariff levels and streamlining tariff systems, and introducing export promotion schemes and current account convertibility. Policies to promote non-oil, non-mineral exports were also implemented in some Arab countries that relied heavily on primary commodities.

Finally, countries like Saudi Arabia can play an important role in integrating the region. The share of Saudi imports originating from the region is very small (see above) partly due to the small industrial base in the Arab countries. However, a large number of products that the region could export to Saudi Arabia are subject to tariffs (Table 1.7). If these tariffs are reduced, the potential for regional integration would improve.

Table 1.7: Bilateral trade agreement between Saudi Arabia and other Arab countries

Bilateral trade agreement with	No. of commodities completely exempt from custom duty	No. of commodities subject to reduced rate of duty
Lebanon	124	29
Jordan	130	38
Morocco	535	0
Syria	121	0
Tunisia	311	0
Egypt	300	0

Source: The NCB Economist, 1996

In conclusion, there seems to be a strong case for enlarging the Arab market, with the understanding that such a market will not be inward looking but open so as to benefit from interactions with the world economy. Widening the market by dismantling national economic barriers will serve the objectives of raising the level of national productivity and of increasing its competitiveness, creating greater opportunities for economies of scale, providing greater attraction to domestic and foreign investment, pooling resources to develop the technological field, permitting a rationalization of investment through more efficient allocation of regional resources, all of which will build up the Arab capability to compete in the world markets.

A regional arrangement among Arab countries could also enhance cooperation in the joint production of public goods—such as education and training or research and development (e.g., in agriculture)—and in the coordination of investment incentives. Furthermore, a unified Arab market will strengthen the negotiating position of the Arab countries vis-à-vis other economic blocks and widen Arab opportunity to benefit from cooperating with them. There are a number of conditions that need to be fulfilled to be able to move along this path. They include, first and foremost, the political will to integrate, even though gradually over time. They also call for setting up a long-term plan to dismantle intra-Arab non-trade barriers, permitting a free flow of capital resources and putting in place the required policy coordination in support of these moves.

II. THE GREAT ARAB FREE TRADE AREA: A NEW HOPE FOR ARAB INTEGRATION?

The quest for Arab unity has been a dominant theme of Arab politics in the twentieth century. The structural dimension of the contemporary Arab unity project has been embodied primarily in the League of Arab States. Created by the then seven sovereign Arab states (Syria, Trans-Jordan, Iraq, Saudi Arabia, Lebanon, Egypt, and Yemen), the Arab League was intended to strengthen relations between the Arab states upon a basis of respect for the independence and sovereignty of these sates. By 1974, as other Arab countries became independent of European control, membership in the League had risen to twenty two, including Somalia and Mauritania as well as Palestine (despite its non-state status). With the unification of Yemen in 1993, the Arab League membership dropped by one, but remained at twenty-two members with the improbable addition of the Comoro Islands during the same year. Today the Arab League is an umbrella organization for 17 specialized agencies, dealing with functions such as maritime transport, civil aviation, economic and social development, cultural and scientific affairs, monetary policy, broadcasting, and telecommunications.

While the League has contributed to functional integration within the Arab world, it has largely failed on the political and economic levels. Economic integration among Arab countries started with the Agreement on Mutual Defense and Economic Cooperation between Arab League States in 1950. Ambitious plans for trade integration contained in the design of the Arab Common Market established in the 1960s have remained largely unimplemented. Several regional integration arrangements followed but had little impact (Box 2.1). The Arab League has been more successful in organizing a common Arab stand on international issues than it has been in regulating inter-Arab disputes or in economically integrating the region. This impotence is partly due to the League's lack of legal and political authority to override the sovereign autonomy of the member states. The search for alternative strategies of economic integration resulted in the establishment of many bilateral or subregional agreements. Cooperation efforts have achieved considerable success in the case of the Gulf Cooperation Council (GCC) established in 1981, especially in terms of economic coordination and harmonization of policies.

Other sub-regional agreements have been attempted. In February 1989, the Arab Cooperation Council (Egypt, Iraq, Jordan, and Yemen) was established. However, it was suspended in 1992 due to Egypt's withdrawal resulting from Kuwait's invasion by Iraq. Also in February 1989, the Union of the Arab Maghreb was established with the objective to encourage joint ventures and creation of a single market among Algeria, Libya, Mauritania, Morocco and Tunisia. However, the agreement ended in a pause in 1993 due to economic differences among member countries. A renewed effort for regional trade integration started in 1997 with the decision to create a Great Arab Free Trade Area (GAFTA) over a ten-year period. GAFTA is designed to include all Arab countries as members, to respond to the circumstances and needs of its various members, and to observe consistency with the rules of the World Trade Organization (WTO). Regional integration efforts have also extended beyond the region, between Mediterranean countries of the Middle East and the European Union.

Box 2.1: Historical overview of regional arrangements in the Arab Region

- 1920s: Several PTAs, e.g. Egypt and Syria, Syria and Saudi Arabia but abolished in the 1930s due to a wave of high protectionism.
- 1941: Establishment of the Middle East Supply Center (MESC) to help during the war, as a trial to provide the supplies required while minimizing imports for that objective. This led to substantial results showing the benefits that could be derived from such a regional integration in the Middle East. However, the end of the war brought the end of such coordination and the relevant countries adopted back again their inward-oriented tendencies.
- 1945: Establishment of the Arab League of States with the objective to strengthen relations between member countries and promote cooperation in economic and financial affairs as well as transport affairs through plans' coordination.
- 1953: The Arab Trade Agreement (ATA'53), as a first attempt to consolidate bilateral agreements, which were many at that time. The Arab Economic Council of the Arab League (7 countries at that time) approved the "Agreement to Facilitate Trade Exchange and Transit Trade among Arab League States" as well as the "Agreement on Settlement of Payments on Current Transactions and on Capital Movements among Arab League States", more known as the " Arab Payments Agreement". The ATA'53 called for trade liberalization by full elimination of tariffs on most agricultural and livestock products and processed foodstuffs, or a 25 percent in normal tariff rate on some items. However, administrative restrictions to trade still applied; Although ATA'53 has been amended several times to increase the scope of liberalization and grant greater preferential margins, it failed.
- 1957: In a parallel effort to ATA'53, the Council for Arab Economic Unity (13 Arab countries) implemented in 1964 the "Arab Economic Unity Agreement" which stipulates the establishment of the "Arab Common Market" (ACM) aiming at the gradual elimination of tariff barriers and quantitative restrictions. This was considered a sort of success since tariff barriers were eliminated in some countries by 1973 and a progress in NTBs' removal was witnessed.
- 1964: While ATA'53 was undergoing its gradual amendments over the 1950s and 1960s, 13 Arab countries engaged in attempts to proceed faster towards economic integration. They got together in 1964 to form the Council for Arab Economic Unity and so moved forward to implement the Arab Economic Unity Agreement of 1957. The main feature of the implementation of this agreement in the trade area was the establishment in 1964 of the Arab Common Market (ACM) which, as a first step, provided for the creation of a free-trade area through the gradual abolition of tariff barriers and quantitative restrictions. By 1973, only 4 members of ACM had eliminated tariff barriers to mutual trade with the exception of tobacco, and some progress had taken place in the removal of non-tariff barriers.
- 1981: The "Agreement of Facilitating and Development of Trade Exchange between the Arab Countries" (ATA'81), signed by 19 members of the Arab League in 1981, aims at liberalizing all trade transactions between Arab Countries from all tariff duties and restrictions on all agricultural and animal products as well as mineral & non-mineral raw materials, while manufactured and semi-manufactured products are subject to a gradual phasing out of tariffs. Product protection from competitive non-Arab commodities was enhanced through the adoption of a unified import duties for these.
- 1995: Putting the ATA'81 into effective implementation did not prove an easy task. Consequently, the Economic and Social Council of the Arab League (ESC) decided in 1995 to form a Task Force of Experts, including professional experts from both the public and the private sectors, to study ways and means of activating the ATA'81 and come up with proposals leading to the establishment of a Great Arab Free Trade Area, GAFTA for short, designed to include all Arab countries as members, to respond to the circumstances and needs of its various members, and to observe consistency with the rules of the World Trade Organization.
- 1997: The conclusions reached by the aforementioned Task Force of Experts were adopted in Resolution No. 1317 of 19 February 1997. According to this resolution, a work program and a timetable was approved in order to implement the ATA'81 as the means to achieve the desired Great Arab Free Trade Area within ten years starting 1st January 1998.

Source: Taher Kanaan, 2000, "Arab Economic Integration Efforts: A Critical Assessment", ESCWA.

a. Implementation program of GAFTA

The Great Arab Free Trade Area (GAFTA) is a new Arab League initiative that attempts to revive unsuccessful regional integration efforts. It consists mainly of liberalization of traditional trade barriers for goods (Box 2.2). The GAFTA's implementation program stipulates the elimination of all tariff barriers and taxes with similar effect on products of Arab origin traded within the Arab region in a gradual manner over ten years by 10 percent per year, starting in 1998. It also stipulates the elimination of non-tariff barriers (NTBs) and administrative barriers. The GAFTA is designed to be compliant with WTO rules. It allows preferential treatment for the least developed countries among Arab countries.

Liberalization of agricultural products is subject to seasonal tariff reductions, whereby member countries are allowed to suspend tariff preferences on some produce during the peak harvest seasons. The Economic and Social Council of the Arab League (ESC) must first approve any products benefiting from such measures. Seasonal exclusions from the tariff and other import tax reductions for any eligible agricultural produce cannot last more than seven months. Moreover, the number of exempted agricultural products exempted should not exceed 10 products for each country, the maximum peak production period should not exceed 7 months in a year for any agricultural product, and the sum of exemption periods for all products should not exceed 45 months in total during the year.

For industrial products, member countries are allowed to draw up a list of products excluded from the tariff reduction scheme for no more than three years. This period cannot be renewed and a single product cannot be granted more than one kind of exception. The sum of the value of all products on the exception list should not exceed 15 percent of the export value of a country to other Arab countries. Such exceptions are intended to enable the local industry to carry out the restructuring needed to improve their competitiveness before having to face competition from other GAFTA countries' imports. At the end of the three-year period, the excluded products will integrate the GAFTA program and will be subject to the cumulated rates of tariff reductions achieved by the other products initially in the program. Arab countries requesting an exception list should present to the ESC an annual report that justifies the necessity to have exceptions, assessing their economic conditions and whether such conditions persist.

Member countries would conduct negotiations concerning economic activities which affect trade liberalization. These include trade-related services, scientific and technological cooperation, coordination of trade policies and legislative systems, and coordination of intellectual property legislation. The rules of origin, defined by the "Rules of Origin Committee", will be used to determine whether the product is an Arab one. The "Committee for the Settlement of Conflicts" handles all implementation issues or conflicts. The ESC is also assisted by the "Executive and Follow-up Committee", the "Trade Negotiations Committee", and the "Technical Secretariat".

Achievements so far. So far, 14 Arab countries have joined GAFTA, accounting for 90 percent of Arab external trade and 95 percent of Arab intra-regional trade. Out of the eight remaining countries, six are least developed countries (Djibouti, Sudan, Somalia, Palestine Authority, Comoros, and Mauritania) and two (Algeria and Yemen) are in the process of economic reform. As of 1/1/2000, duties have been lowered by 30 percent. However, many tariff-like barriers have not been lowered yet. A common list of exemptions from the program defining the products which

cannot be imported for religious, health, or security reasons has been adopted. This list is to be reviewed on a yearly basis. The agricultural calendar with regard to exemptions from gradual tariff duties reduction in times of peak production has been submitted by member countries and agreed upon. All countries have respected the rules of 7-month peak period and 45-month maximum (Table 2.1). The lists of non-agricultural products to be exempted from the implementation program have also been submitted. Six Arab countries (Jordan, Syria, Egypt, Tunisia, Lebanon, and Morocco) got approval for their exception list in 2000 for three years. Finally, the last semi-annual review was undertaken in September 2000.

Box 2.2: Highlights of GAFTA's implementation program

A work program and a timetable were approved to implement the ratified ATA'81 as the means to achieve the desired Great Arab Free Trade Area (GAFTA) within ten years starting 1st January 1998. The following are highlights of the implementation program:

1. Products defined in the implementation program shall be treated as national products of member countries.
2. All duties on products traded among the member countries, as per tariff schedules in force on 31 December 1997, shall be gradually reduced in equal installments until they are completely removed within ten years starting as of 1st January 1998 and ending on 31st December 2007.
3. Participant countries can agree to place certain products under direct tariff liberalization.
4. Products of Arab origin traded under the implementation program shall not be subject to non-tariff barriers of any kind whatsoever.
5. Definition of the rules of origin to qualify products as of Arab origin will be undertaken by the "Rules of Origin Committee". Certificates of origin for all commodities exchanged under this program need to be provided.
6. An agricultural calendar will be drawn up to define the seasons during which certain agricultural products may not qualify for tariff exemptions. These exemptions should be limited to a timetable; the maximum data until which these exemptions can be applied is at the conclusion of the program (31st December 2007).
7. A preferential treatment will be accorded to countries classified as least developed countries by the UN and the Palestinian territories. The nature of the treatment and its time period should be defined by the Council.
8. The ESC will conduct a semi-annual review of implementation.
9. A "Committee for the Settlement of Conflicts" will be set up to deal with all implementation issues or conflicts.
10. Member countries shall conduct negotiations with regard to economic activities affecting trade liberalization, namely, trade-related services, scientific and technological cooperation, coordination of trade policies and legislative systems, and coordination of intellectual property legislation.
11. The ESC shall oversee the implementation of the program and shall be assisted in this task by the Executive and Follow-up Committee, the Trade Negotiations Committee, the Rules of Origin Committee, and the Technical Secretariat.
12. International (WTO) rules and standards will be considered in dealing with dumping, subsidies, and balance of payments problems resulting from the implementation of the program.
13. Participant states are committed to the principle of "transparency" and would inform the ESC about their procedures, reports, and special list of exceptions with respect to trade.
14. The rules of this program do not apply to goods whose imports are prohibited for religious, health, environment, and national security reasons.
15. A study will be pursued by the General Secretariat of the Arab League on the method for treating products in the Free Trade Zones.

Source: The Arab League

b. Assessment of GAFTA's potential

To some extent, the GAFTA was established out of concern that the Euro-Mediterranean partnership might create a bilateral trade pattern which would discourage intra-Arab economic ties. Moreover, the implementation of the Uruguay Round Agreements are expected to reduce the preferences that Mediterranean Arab countries had enjoyed to access EU markets. Therefore, shifting trade flows towards intra-regional markets has become more desirable.

Several gains could be derived from GAFTA. First, it could facilitate a smooth and gradual integration in the world new trading system, and could create a collective approach to negotiations with WTO and other regional blocs. Second, it could increase the volume of intra-Arab trade and promote industrial development, especially in those industries which are likely to face challenges abroad under the WTO Agreement. Third, it would generate confidence among domestic and foreign investors, thus encouraging investment flows between member countries and attracting foreign direct investment and transfer of technology.

In addition, the adopted across-the-board approach for tariff reductions under GAFTA offers the advantage of being transparent and ensures that high tariffs are reduced faster than lower tariffs in absolute terms. However, the extent to which the tariff reductions will boost intra-regional trade flows is also dependent on tariff dispersion and the effective rate of protection across industries in individual member countries. Moreover, since some countries have high tariff protection (e.g., Egypt and Syria), the liberalization approach could have a significant trade creation effect.

There are several difficulties in the design and implementation of GAFTA, many of which arise from the fact that member countries are diverse in terms of their economic development and their level of reforms. Some countries have pursued far-reaching economic reforms (e.g., Egypt, Jordan, Morocco, and Tunisia) while others have not yet shifted away from traditional import-substitution strategy and a reduced role of the state (e.g., Syria and Iraq).

First, the list of exceptions is undermining GAFTA's effectiveness. The safeguard measures give members the right to exclude from immediate liberalization certain industrial and agricultural products. Typically, products in the industrial exception list are either not subject to the agreed general reduction in tariffs, or subject to total import prohibition. Although the principle of providing a period whereby local industries adjust to increased competitiveness resulting from free trade is justified, this process has been taken too far and is rendering GAFTA less effective in its objective of promoting intra-regional trade through better reallocation of resource.

In terms of size, there are too many products in the exception lists. In 1999, Egypt has requested 679 products (at the six-digit level) in its exception list, of which 642 are subject to full import prohibition. Morocco has put 804 products in its exception list, not to be subject to the tariff reduction. Syria requested 229 products to be subject to total import prohibition. Tunisia, Lebanon, and Jordan put 161, 41, and 35 products respectively in their exception list, not to be subject to the tariff reduction (Table 2.2).

Table 2.1: Agricultural calendar, 2000

Item	Code	Product	Jordan	Tunisia	Saudi Arabia	Syria	Iraq	Oman	Kuwait	Lebanon	Lybia	Egypt	Moroco
			from:to	from:to	from:to	from:to	from:to	from:to	from:to	from:to	from:to	from:to	from:to
1	070190	potatoes	5/31:11/1	11/30:9/1 5/31:2/1	6/30:12/1	10/31:4/1		6/30:2/1	4/30:2/01	7/31:4/20	7/31:6/1 2/28:12/1	3/31:12/1	10/31:5/1
2	070200	tomatoes		4/30:10/1	8/31:5/1	6/30:3/1	12/1:6/1	5/31:12/1	4/30:1/1	8/15:2/15		8/31:3/1	
3	070310 071220	onion	10/31:5/1	10/31:6/1	11/31:5/1	6/30:4/1 11/30:9/1			5/31:4/1	9/15:6/15	9/30:7/1		
4	070320	garlic	9/30:5/1	10/31:5/1					5/31:3/1		9/30:7/1		11/30:5/1
5	070930	eggplant			8/31:6/1				1/31:11/1				
6	070410	cabbage						3/15:12/15	2/28:12/1				
7	070610	carrots			5/31:2/1			2/29:12/1					
8	070700	cucumber			8/31:5/1			4/15:10/15	6/30:5/1	6/30:4/1			
9	070820	beans	9/30:7/1										9/30:6/1
10	070910	artichoke		4/30:1/1									
11	070960	red peper		4/30:1/1									
12	070990	green olives											
13	070990	courgette			8/31:5/1				4/30:4/1 10/31:9/1				
14	070990	okra			8/31:5/1								
15	080300	bananas	5/31:3/1 1/31:11/1					12/31:7/1					
16	080410	dates					1/1:8/1	4/15:9/15			11/30:8/1		1/31:7/1
17	080450	guava											
18	080510	orange	3/31:12/1			3/31:10/1	4/1:10/1			2/15:10/15		5/31:11/1	5/31:1/1
19	080520	mandarines								2/15:10/15		3/31:12/1	
20	080520	clementine				1/31:9/1							
21	080530	lemon	3/31:11/1			2/29:9/1		8/30:6/1					
22	080610	grapes	10/30:8/1	11/30:8/1			12/1:6/1			12/31:09/01	9/30:6/1	9/30:6/1	9/30:6/1
23	080711	water melon		6/30:4/1	8/31:5/1	8/31:5/1		1/15:12/15 6/15:4/15		08/31:06/01		8/31:5/1	
24	080719	melon			8/31:5/1	7/31:6/1		7/31:5/1				8/31:5/1	
25	080810	apples	12/31:9/1			2/28:10/1				05/31:10/01		11/30:5/1	11/30:6/1
26	080820	pears								11/30:09/01		9/15:7/15	
27	080910	appricots		7/30:6/1								6/30:4/1	7/31:5/1
28	080930	peach	9/30:8/1	9/30:7/1									
29	080940	plum											7/31:5/1
30	081090	pomegranate					1/1:7/1						
Average month number			45	45	45	45	29	45	23	41.1	19	45	45

Source: The Arab League

Table 2.2: Industrial exceptions, 1999

Country	Total Number of Products	Type of Exception
Jordan	35	Stop progressive tariff reduction
Tunisia	161	Stop progressive tariff reduction
Syria	229	Forbid import
Lebanon	41	Stop progressive tariff reduction
Egypt	679	Forbid the import of 643 products and stop progressive tariff reduction on 36 products
Morocco	804	Stop progressive tariff reduction

Source: The Arab League

In terms of content, most of the excluded products are goods that compete with domestic production. They consist largely of processed foodstuffs, semi-manufactured, and consumer goods—e.g., textile and ready-made clothing, plastics, mechanical appliances and television sets, motor vehicles, steel, and iron sheets (Table 2.3). This "infant industry" protection may lead to resistance by interest groups to open up their markets at a later stage. If such pressures are not resisted, the liberalization process may create problems in implementing tariff reductions in the future and GAFTA would not be able to realize its full potential for regional trade expansion. Moreover, it is not clear on what basis these products are selected and what additional measures each country is taking to increase their competitiveness during the transition period.

Most products on the exception list are similar across countries, reflecting similar production structures among them. The three most important categories are textile products, metal products, and machinery. Textile products are important for many Arab countries, like Egypt, Syria, Tunisia, and Morocco, accounting for a large share of domestic production and employment (Table 2.4). This raises the concern that these countries will compete rather than complement each other, thus creating pressures in sectors that are too important for production and employment to afford any tension.

However, it is important to recognize that greater competition among Arab countries in these sectors will increase the efficiency of production. There is also potential for intra-industry trade, whereby countries can export similar but differentiated products. Moreover, increased competition in such sectors will have to be faced sooner or later as these countries join the WTO. This is especially true for textile where the MFA is being dismantled globally. Therefore, Arab countries need to use the three-year grace period for which the exception is granted to improve their competitiveness, rather than simply benefit from added protection.

Table 2.3: List of exceptions by product

Description	2 digit HS code	Egypt	Jordan	Lebanon	Morocco	Syria	Tunisia
Gypsum, anhydrite	25		x	x			x
Fluoride and iodine	28				x		x
Polymers and ethylene	39				x		x
Natural rubber	40						x
Raw hides & skins of bovines animals	41		x				
Saddlery and harness	42						x
Newsprint	48						x
Wool	51				x		
Cotton fabrics	52	x			x	x	x
Flax	53	x					
Sewing thread	54	x			x		
Synthetic	55	x			x		
Wadding of textiles materials	56				x		
Carpets	57	x	x		x		x
Woven pile fabrics	58	x			x		
Gum-coated textile for books	59	x			x		
Knitted	60	x			x		
Men's coat	61	x	x		x	x	
Men's overcoat	62	x	x		x	x	x
Blankets	63	x			x		
Waterproof footwear	64						x
Marble	68					x	
Ceramics bricks	69			x	x		
Pig iron and spiegeleison	72	x	x				x
Copper Mattes	74			x			
Unwrought aluminium	76		x	x			x
Frigerator	84				x		
Electronic motors	85			x	x		x
Tractors	87	x	x		x		x
Optical fibers, lenses	90						x
Furniture	93					x	
Seats	94			x			x

Source: The Arab League

Table 2.4: Production and employment in manufacturing, 1998

Countries	Food, beverages & tobacco	Textile, & leather	Wood products	Paper, publishing, printing	Chemicals, petroleum products	Non-metallic minerals	Basic metal	Fabricated metal, machinery	Other	Total
	Share in production (in percent)									(million of local currency)
Egypt	20.7	10.8	0.7	3.8	31.6	8.0	7.8	16.6	0.1	126,597
Syria	28.0	18.5	4.6	2.0	25.0	8.0	1.8	11.5	0.5	296,375
Jordan	21.6	5.1	0.8	5.0	40.7	10.2	4.9	8.9	2.8	3,033
Lebanon	26.8	15.2	3.5	5.6	7.9	11.4	5.6	13.7	10.2	5,230
	Share in employment (in percent)									(thousands)
Egypt	17.3	29.4	1.6	2.3	15.2	7.9	6.8	19.0	0.5	1,464
Syria	31.0	28.3	0.7	0.5	13.4	18.6	1.7	5.8	0.0	104
Jordan	19.3	13.0	3.0	6.5	17.2	14.6	1.8	15.8	8.9	112
Lebanon	23.8	20.8	4.6	5.7	5.2	10.0	1.9	15.0	13.1	169

Source: ESCWA, 1999, Bulletin of Industrial Statistics for the Arab Countries: 1990-98.

Second, the rules of origin are loosely defined. Rules of origin are quite difficult to define (Box 2.3). The GAFTA embodies rules of origin for duty-free treatment. A broad rule of 40 percent of value added has been set with few details. Rules for cumulation of origin among GAFTA countries have been adopted, thus allowing for materials obtained from one member country and incorporated into a product worked out or processed in another member country to be considered as obtained in the latter country. Although a detailed rule of origin is currently being prepared, the current definition is so broad that it threatens countries from strong competition coming from outside the region. This has prompted countries to put products potentially subject to non-Arab competition in their exception list, and has exacerbated the ineffectiveness of the GAFTA.

The Egyptian authorities, for example, have raised the issue of textile in relation to the rules of origin. Although Egypt is competitive in textile vis-à-vis countries of the region, and would be ready to open up trade with the region in this sector, it fears that this would prompt imports from highly competitive countries such as Indonesia to be channeled to Egypt via other Arab countries, such as the Gulf countries which have an open trade regime. This is likely to happen because of the loosely defined rules of origin. Egypt is not yet ready to open up its trade and compete with countries like Indonesia. In order to remedy the situation, Egypt has put products where it feels it could be threatened by the rule of origin into its exception list.

Third, taxes and charges with similar effects as tariffs remain largely untouched. GAFTA's implementation program states clearly that the progressive tariff reduction should include charges and taxes with similar effects as tariffs. These charges are defined as the extra charges and taxes a state imposes on imported products, but not on national products (charges collected for a specific service such as storage or transport are not included in the definition). Such charges have the same protection effect as a tariff. They are imposed on a continuous basis and not in relation to special economic or trade conditions like dumping or balance of payments problems.

Box 2.3: Rule of origin: definition and computation

Definitions of the rules of origin. Rules of origin are laws, regulations, and administrative determinations used by countries to determine the nationality or the origin of a product. The authorities of an importing country may have several reasons for wishing to determine the origin of a product or the place in which the last or the most important processing step took place:

- A product may be entitled to preferential tariff treatment if it comes from a developing country or from a member of a regional agreement (custom union, free trade area, most-favored nation).
- The product may be subject to anti-dumping or countervailing duties, or to safeguard measure if it originates in a particular country.
- There may be import quotas, along with other prohibitions and restrictions for the product that set limits on the access of products according to the country of origin.
- Product labeling and marking requirement may need to be verified.
- Origin may be needed for the purpose of import statistics.

Categories of rules of origin. There are two kinds of rules of origin, preferential and non-preferential. The former is applied within the context of trade cooperation arrangements between member countries, such as free trade areas, while the latter is applied outside such arrangements. Preferential rules of origin have recently been given more attention because of the increasing of regional agreement. They ensure that only the goods that are made in the countries party to the trade agreement obtain the benefits such as reduced rates of duty. Preferential rules of origin regulate the conditions of access to a preferential market in the absence of a common external tariff among trade partners concerned. They also ensure that the transshipment of goods, or the importation of goods that have undergone only minimal processing in the beneficiary country, does not benefit from trade preferences in the importing country.

Methods of determining the rules of origin. Determining the origin of a traded manufactured product is a very complicated process that necessitates the application of a series of criteria to define the origin of such a product. It is made harder especially when inputs (raw materials and spare parts) are manufactured all over the globe. What complicates the matter is the fact that different countries apply different rules to determine the origin of a product. When a particular product is wholly made in one country, the determination of its origin may not present a problem. Difficulties arise in those products whose production involves more than one country. According to the WTO agreement on the rules of origin, the origin of a product should be determined either where the product is wholly obtained or, in the case of more than one country is involved in its manufacturing, where the last *substantial transformation* has been carried out. Views differ on the exact meaning of this concept. Thus, substantial transformation is determined by applying one of three different methods:

- **Percentage of value added:** Under this method, a minimum percentage of the value of a good must have been added within the country or preferential area for which origin is being claimed. The value added is either stated in terms of the value added of the components of the product, or the increased market value of the product. This method is usually applied to complex production processes where it is difficult to ascertain the last "substantial process".
- **Change in tariff heading:** Under this method, the "substantial transformation" is said to have occurred if a good is classified to a different tariff heading or subheading than that of its component materials after production. The minimum change within the HS nomenclature should be taken in account. List of exceptions and additional criteria usually supplement this method. It fits more large clusters of products, as in the case of textile and clothing. However, the weakness of this method is in the supplementary list of exceptions and criterion, and in the fact that the change in tariff heading could be inaccurate.
- **Specified process of manufacture:** The criteria used here may take mainly two different forms. It may entail a detailed account of the manufacturing process that confers or does not confer origin. In this case, it could involve the addition of a component part pf a particular finishing process. Although this method is explicit, it may not suit a process that encompasses a large variety of different products.

Source: Soha Atallah, 2000, background paper for ESCWA.

Taxes and charges with similar effects as tariffs represent a big obstacle o trade among Arab countries. They are unclear; they are imposed by different and numerous government bodies; importing and exporting countries are not informed about them in advance; and they have a large impact on the market value of the product. These charges hinder the private sector's ability to predict accurately the cost of import and export. They also discourage foreign and local investment within the region and reduce competitiveness by increasing product cost. All Arab countries impose such charges, with the exception of Saudi Arabia, Kuwait, Oman, Qatar, and Bahrain.

In order to reduce distortions related to charges and taxes with similar effect as tariffs, several steps could be implemented. Member countries need to identify and clarify the application of such charges in their countries. These charges need to be merged with the tariff schedule. The progressive charges, such as stamp duties, need to be abolished as they exacerbate the problem. Finally, they should be subject to the same annual 10 percent reduction as the tariffs within GAFTA.

Fourth, non-tariff barriers need to be identified and dealt with appropriately. Many countries that have signed the GAFTA agreement are imposing non-tariff barriers that are undermining the effectiveness of GAFTA by tremendously constraining intra-regional trade flows. Moreover, GAFTA members have not yet entered into negotiations to remove any type of non-tariff barriers. Such non-tariff barriers can take many forms—administrative, quantitative, and financial. They can arise from the interpretation of the products whose trade is prohibited on the basis of religion, environment, health, and security, or from lack of knowledge of customs officials about the details of the GAFTA, or from difficult or inefficient customs and administrative procedures. For example, import of potatoes from another Arab country can be delayed for weeks as local authorities are checking their fertilizer content in accordance with health standards.

Quantitative restrictions (QRs) on imports are an important non-tariff barrier to trade. Although the use of quantitative restrictions has been declining among countries of the region—partly as a result of autonomous trade reforms—non-tariff barriers in the form of import licensing for safety and health standards are still applied, mainly for processed foodstuff and, to a lesser extent, semi-manufactures. Such NTBs are sometimes misused and inhibit trade. In countries like Syria import licenses are required for virtually all imports. GAFTA could adopt a similar process to deal with import quotas as the WTO, where QRs are converted to tariff charges and included in the tariff schedule. Under WTO, QRs are only allowed under special circumstances like dumping and balance of payments problems.

Barriers to cross-border trade have also been reported. Freight transportation by road plays an important role in intra-regional trade exchange. Member states of the Arab League signed the 1977 agreement to facilitate transit of goods and persons across Arab countries. However, there has been no legal enforcement for the implementation of this agreement while complaints regarding barriers to cross-border trade continue. These range from closure of roads and motorways for political reasons to delays due to cumbersome cross-border regulations (such as no driving on week-ends and public holidays, or refusal of visa issuance for professional drivers of certain nationalities).

The numerous and different forms of NTBs make their abolition a difficult task. Identifying all NTBs is an important first step in solving the problem. Sharing information about NTBs among Arab countries and using modern technology like computers and Internet to alert traders about NTBs will

help speed up the process. Provisions for harmonization or mutual recognition of mandatory product standards, testing and certification procedures, and environmental standards are necessary. Although the GAFTA program calls for some harmonization related to customs clearance procedures, it does not contain such explicit provisions. The private sector could play an important role in dealing with NTBs by using modern and technologically-advanced methods of checking and inspecting merchandise. This will help prevent delays or damage to products at the border.

Fifth, a credible dispute mechanism is needed. It is clear that many GAFTA-member countries are not abiding by the GAFTA rules or the decisions of ESC. This is evident, for example, with respect to NTBs, exceptions, periodical reports, or exaggeration in the interpretation of safeguard mechanisms. The lack of obedience of agreed rules is hindering the successful implementation of GAFTA. Although a dispute settlement body exists within the Arab League, its rules and regulations need to be clarified. More importantly, its enforcement mechanisms need to be strengthened in order to remain credible.

c. Compatibility between GAFTA and WTO

The GAFTA agreement was designed to be compatible with WTO rules and fits the conditions for regional integration imposed by the WTO in Article 24 (Box 2.4). Under the WTO, the implementation period for a free trade agreement should not exceed 10 years (in special cases an additional two years can be granted). Moreover, the free trade agreement should not lead to an increase in protection against non-members beyond the level established prior to the agreement. It is in this framework that GAFTA was established. GAFTA also follows WTO rules regarding trade-related issues such as subsidies, services, and intellectual property rights.

The issue of compatibility of GAFTA with WTO arises partly because some members of GAFTA are not members of WTO, and therefore are not subject to the same rules. The most important inconsistency is due to the treatment of NTBs. Until now, the Arab countries that are both members of WTO and GAFTA are: Jordan, Emirates, Bahrain, Tunisia, Qatar, Egypt and Morocco. Saudi Arabia and Oman are still in the negotiating stage. Only 4 Arab countries are not yet members of WTO: Lebanon (which has observer status), Syria, Libya and Iraq.

On the one hand, GAFTA member countries can retain the application of NTBs or even impose them on new products as part of their exceptions list. On the other hand, Arab countries that are already members of WTO are not allowed to impose NTBs among themselves due to their commitment to the WTO agreement, but are imposing NTBs to Arab countries that are not WTO members. This dichotomy is creating distortions within GAFTA. The problem of NTBs is limited to Lebanon, Syria, Iraq, and Lybia since Saudi Arabia and Oman do not apply NTBs. A summary of the consistency and contrast between GAFTA and WTO is provided in Box 2.5.

Box 2.4: Regionalism—the basic rules for goods under WTO

Article 24 of GATT deals with regional trade agreements. Its main interpretation includes:

- Recognition that customs and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and toady cover a significant proportion of world trade;
- Recognition the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements;
- Recognition also that such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector is excluded;
- Reaffirmation that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other members with such territories; and that in their formation or enlargement the parties to them should to the greatest possible extent avoid creating adverse affects on the trade of other members;
- Conviction also of the need to reinforce the effectiveness of the role of the Council for Trade in Goods in reviewing agreements notified under Article 24, by clarifying criteria and procedures for the assessment of new or enlarged agreements, and improving transparency of all Article 24 agreements;
- Recognition of the need for a common understanding of the obligations of members to ensure observance of the provisions of Article 24 by the regional and local governments and authorities within its territories.

According to Article 24, the contracting parties recognize the desirability of increasing freedom of trade by the development of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or free trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

Accordingly, the provisions of Article 24 do not prevent, as between the territories of contracting parties, the formation of a customs union or of a free trade area, provided that:

- (a) with respect to a customs union, the duties and other regulations of commerce imposed at the institution of any such union shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union;
- (b) with respect to a free trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such interim agreement to the trade of contracting parties not included n such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free trade area;
- (c) any interim agreement referred to in (a) or (b) above shall include a plan and schedule for the formation of such a customs union or free trade area within a reasonable length of time.

These provisions thus call for the evaluation of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union. This assessment should be based on weighted average tariff rates and customs duties collected and on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. Moreover, the "reasonable length of time" referred to should not exceed 10 years, except in exceptional cases.

Source: www.wto.org

Box 2.5: GAFTA and the WTO: how compatible?

Consistency with the rules of the WTO:

1. Compliance with the general rules set by WTO regarding the formation of a free trade area, stated in Article 24 of the WTO agreement. GAFTA has set a 10 years timetable as a maximum date to the conclusion of its Implementation Program, as required by WTO.

2. Abolition of Non-Tariff Barriers (NTBs). The Economic Social Council of the Arab League, which is the institutional body responsible of the Implementation Program of GAFTA, has set many rules that dictate the abolition of NTBs in all its forms: quantitative, administrative, and financial.

3. Adherence to the "national treatment" rule and transparency in the trade exchange among Arab countries.

4. Compliance to the "special treatment" rule towards the least developed countries.

5. Protection of Intellectual Property Rights.

6. Rules of origin, standards, subsidies, safeguards conditions, rules for dumping and balance of payments difficulties are treated within GAFTA in accordance to WTO rules.

Contrast with the rules of the WTO:

1. WTO applies the reciprocity principle while preferential treatment is applied in GAFTA with respect to the least developed countries. Although WTO implements the special treatment principle towards the least developed countries, it is for a specific period only in order to allow countries to adjust to WTO agreements. However, in the context of GAFTA, this special treatment is defined according to the demands and the economic conditions of every state.

2. While WTO permits monopoly in the field of technology, GAFTA member countries cooperate with each other in the field of technology and the scientific research.

3. WTO has successfully abolished the application of NTBs by converting them to tariff charges. However, the application of these NTBs persists in GAFTA until the date of its conclusion, namely in 2007, except for Arab countries that have already joined WTO.

4. The WTO dictates that trade through bilateral agreements should end by 2005, and the Most Favored Nation (MFN) principle should be applied instead, unless these bilateral agreements stem from a free trade area or customs union among concerned states. By contrast, GAFTA has allowed the conclusion of bilateral agreements providing that they do not contain privileges that exceed what is stated in the implementation program of GAFTA. Moreover, these bilateral agreements should end by 2007, the date of the conclusion of the implementation program of GAFTA.

Source: M. Suleiman, "GAFTA and the Global Trade System", 2000.